**EB-2019-0242**

**ONTARIO ENERGY BOARD**

**ASSOCIATION OF MAJOR POWER CONSUMERS IN ONTARIO (AMPCO)**

**Application for Review of an Amendment to the Independent Electricity System Operator Market Rules**

# BRIEF OF AUTHORITIES TO AMPCO'S SUBMISSIONS FOR MOTION FOR STAY


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EB-2019-0242
Brief of Authorities to
AMPCO Submissions for Motion for Stay

**TAB A**

*Association of Major Power Consumers in Ontario (Appellant) v. Ontario (Energy Board), 2007 CarswellOnt 4273 (Div. Ct.)*

2007 CarswellOnt 4273
Ontario Superior Court of Justice (Divisional Court)

Assn. of Major Power Consumers in Ontario v. Ontario (Energy Board)

2007 CarswellOnt 4273, 228 O.A.C. 11

# ASSOCIATION OF MAJOR POWERCONSUMERS IN ONTARIO (Appellant) and ONTARIO ENERGY BOARD, INDEPENDENT ELECTRICITY SYSTEM OPERATOR, ASSOCIATION OF POWER PRODUCERS OF ONTARIO, CORAL ENERGY CANADA INC.,ELECTRICITY MARKET INVESTMENT GROUP, HYDRO ONE NETWORKS INC., ONTARIO POWER GENERATION INC., TRANSALTA ENERGY CORP., TRANSALTA COGENERATION L.P., TRANSCANADA ENERGYLTD., and VULNERABLE ENERGY CONSUMERS COALITION (Respondents)

Greer J.

Heard: May 31, 2007
Judgment: July 3, 2007
Docket: Toronto 207/07

Counsel: Freya Kristjanson, Elissa Goodman for Appellant, “AMPCO”
Alan Mark, Kelly Freedman for Respondent, Independent Electricity System Operator (”IESO”)
Elisabeth DeMarco, Robert Frank for Respondent, Association of Power Producers of Ontario (”APPrO”)
Martine Band, Donna E. Campbell for Respondent, Ontario Energy Board (”OEB”)
George Vegh for Respondents, Coral Energy Canada Inc. (”CORAL”), Transcanada Energy Ltd. (”TEL”)
Matthew Clarke for Respondent, Electricity Market Investment Group (”EMIG”)
No one for Hydro One Networks Inc., Vulnerable Energy Consumers Coalition

Subject: Public; Civil Practice and Procedure

**Related Abridgment Classifications**

Public law
IV Public utilities
IV.5 Regulatory boards
IV.5.c Practice and procedure
IV.5.c.iii Statutory appeals
IV.5.c.iii.D Miscellaneous

**Headnote**

Public law --- Public utilities — Regulatory boards — Practice and procedure — Statutory appeals — Miscellaneous

**Table of Authorities**

**Cases considered by *Greer J.*:**

 

*Dialadex Communications Inc. v. Crammond* (1987), 57 O.R. (2d) 746, 34 D.L.R. (4th) 392, 14 C.P.R. (3d) 145, 1987 CarswellOnt 837 (Ont. H.C.) — referred to

*Ontario (Minister of Natural Resources) v. Mosher* (2003), 2003 CarswellOnt 3783, 41 C.P.C. (5th) 66 (Ont. C.A.) — referred to

*Operation Dismantle Inc. v. R.* (1985), [1985] 1 S.C.R. 441, 59 N.R. 1, 18 D.L.R. (4th) 481, 12 Admin. L.R. 16, 13 C.R.R. 287, 1985 CarswellNat 151, 1985 CarswellNat 664 (S.C.C.) — referred to

*RJR-MacDonald Inc. v. Canada (Attorney General)* (1994), [1994] 1 S.C.R. 311, 1994 CarswellQue 120F, 1994 CarswellQue 120, 54 C.P.R. (3d) 114, (sub nom. *RJR-MacDonald Inc. c. Canada (Procureur général))* 164 N.R. 1, (sub nom. *RJR-MacDonald Inc. c. Canada (Procureur général))* 60 Q.A.C. 241, 111 D.L.R. (4th) 385 (S.C.C.) — followed

**Statutes considered:**

*Canadian Charter of Rights and Freedoms*, Part I of the Constitution Act, 1982, being Schedule B to the Canada Act 1982 (U.K.), 1982, c. 11
Generally — referred to

*Electricity Act, 1998*, S.O. 1998, c. 15, Sched. A
Generally — referred to

s. 4 — considered

s. 32 — referred to

s. 33 — referred to

s. 33(9)(b) — referred to

***Greer J.*:**

1 The parties before me are all involved in the energy business or its regulation and sale. For ease of reference, I have, in the style of cause where counsel are listed, set out the acronyms that each is known as in their energy circles. I will use these acronyms throughout these Reasons.

2 At the opening of the Motion before me, EMIG moved to amend the style of cause in this matter, as several of the players are now off the Record. The Motion was on consent of the parties and I have signed that Order accordingly, removing the following from the style of cause:

1. Electricity Market Investment Group

2. Ontario Power Generation Inc.

3. Transalta Energy Corp.

4. Transalta Cogeneration L.P.

3 The Appellant (”AMPCO”) seeks a stay of the Order and Decision of the Ontario Energy Board (”OEB” or the “Board”) issued on April 10, 2007 and corrected on April 12, 2007 (”the Order”), pending the disposition of AMPCO’s Appeal from the Order of the Board, regarding a Market Rule Amendment.

4 The Motion took a full day to be heard and the materials filed by all counsel are both thorough and extensive.

 

5 AMPCO says a stay of the Board's Order is required, as there is a serious question to be tried, namely the interpretation of the OEB's jurisdiction under section 33 of the *Electricity Act, 1998* (the "Act") and whether the Board erred in holding it lacked the jurisdiction to consider the natural justice and procedural fairness issues under section 33 of the Act. AMPCO also says that the balance of convenience favours the granting of the stay since it and its members would suffer irreparable harm if the stay were not granted. It further says that there is no urgency in implementing the Board's decision, which it now has under appeal.

6 The Respondents, who now remain on the record in this matter, including the OEB, oppose the issuing of a stay, and say it is an ill-conceived move on the part of AMPCO. Further, they say, there is no serious issue to be tried. They say that the appeal is bound to fail.

7 The Respondents also say that the Act is explicit as to the scope of the Board's review of such Market Rule Amendments. They further say the Board's role is explicitly to consider whether the amendment is inconsistent with the purposes of the Act or unjustly discriminates against, or in favour of, a market participant or class of market participants. Finally, they say that the scope of the Board's power does not include examining the rule-making process.

8 The Respondents say that the balance of convenience favours not granting the stay requested, as they say they are the ones who would suffer irreparable harm if the stay is granted.

**Some background information**

9 The Respondent, IESO, is a statutory non-profit corporation with a public interest mandate to direct the operation of Ontario's electricity transmission grid and to operate the electricity market in Ontario. It is also a corporation continued pursuant to section 4 of the Act. Under section 32 of the Act, it has legislative authority to make rules governing the electricity grid and markets relating to electricity and ancillary services ("Market Rules"). It also has the power to amend those Rules.

10 The objectives of these Rules are to govern the grid and to establish and govern "efficient, competitive and reliable markets for the wholesale sale and purchase of electricity and ancillary service in Ontario". The Board oversees the Market Rules and may look at the power given to IESO under the Act to make such amendments. The Board also has the power to revoke a Market Rule Amendment, either on its own Motion or upon Application.

11 AMPCO applied to the OEB to review, on two grounds, an IESO Market Rule Amendment MR-00331-R00 promulgated on January 17, 2007, namely:

> (a) the IESO had breached the rules of natural justice and procedural fairness, in particular the rule against bias and breach of legitimate expectations, and
>
> (b) substantive issues relating the Market Rule Amendment.

The OEB held that it did not have jurisdiction to consider failures of procedural fairness and natural justice by the IESO in the course of a section 33 statutory review. IESO says that the Board found that these are questions for judicial review, best reserved for the courts upon application for judicial review of the decision. IESO says that the words of the statute are "crystal clear" and there is no serious issue to be tried, because the Board correctly construed the scope of its authority.

12 The parties differ on what they see as the result of the Market Rule Amendment. AMPCO says that its members will be faced with increased costs, whereas IESO says that the likely result is that there will only be a *de minimus* increase, if there is any increase at all, but the more likely scenarios is that there will be an average decrease in consumers' overall electricity bills. (See: pp.23 and 25 of the Board's Decision.) The Amendment, which was passed by IESO, dealt with the changes in the ramp rate multipliers, and this change was upheld by the Board.

13 IESO also says that a stay of the Board's Decision will not legally prevent the implementation of the Market Rule Amendment pending appeal, since the Board refused to revoke the Amendment and refused to stay the operation of the

  

Amendment pending appeal to this Court. It found the Amendment to be consistent with the purposes of the Act. (See: p.26 of the Decision.) While the Board was hearing the Application, there was a stay during the 60 days given to the Board to hear the matter and reach its decision.

14 At the hearing, there were a number of Intervenors allowed to make submissions. They are among the Respondents before me in this Motion for a stay. The Board's Decision is 29 pages in length and examines, in great detail, the position of all the parties before it. The Board found that the old 12x ramp rate multiplier "distorts the wholesale market price downwards and engenders adverse consequences for the marketplace in the form of generation and demand side inefficiencies." It agreed with the IESO Amendment changing the ramp rate multiplier to 3x. It refused to refer the Amendment back to the IESO for further consideration, and it then lifted the stay when its Decision was released.

15 AMPCO has a statutory right of Appeal under the Act.

**The Test for granting a stay**

16 The test for granting a stay of the Amendment, pending appeal, is the same as that for the granting of an injunction, as set out by the Supreme Court of Canada in *RJR-MacDonald Inc. v. Canada (Attorney General)*, [1994] 1 S.C.R. 311 (S.C.C.) at p.334. It is a three-part test as follows:

***(a) At the first stage of the test, the Applicant must demonstrate that there is a serious question or issue to be tried.***

17 AMPCO asks for a stay of the Amendment to the Market Rules, since it says it will be prejudiced by the change in the ramp rate multiplier now effected by the Board's decision, while waiting for its Appeal to be heard, if a stay is not granted.

18 The Respondents say that there is no prejudice, which will result if such a stay is not granted, or if there is any, it is *de minimus*, and that a stay under these circumstances is not warranted, as there is no serious issue to be tried.

19 The threshold of determining whether there is a serious issue to be tried, is a low one. The Respondents point out that in certain instances, the moving party must prove that there is a "strong *prima facie* case" before the other two branches of the test are even examined. This, is also the position of APPrO, where it says, facts are not substantially in dispute in the Decision reached by the Board. See: *Dialadex Communications Inc. v. Crammond* (1987), 34 D.L.R. (4th) 392 (Ont. H.C.) at para. 11 and see also, *RJR-MacDonald*, *supra.*

20 It seems to me that the issues, which AMPCO says are to be dealt with, namely whether an error of law or jurisdiction occurred, or whether the Board failed to apply principles of statutory interpretation to the question of its jurisdiction to consider these issues, have no urgency to them, which would require that a stay be granted. These are legal issues, really not much affected by the facts of the case.

21 Further, CORAL and TEL point out that AMPCO has not provided a strong case for a stay, adopting the principles as noted above in *Mosher*, *supra.* AMPCO's proposition that the OEB has the equivalent of the power of judicial review over the IESO, is not a plausible proposition, they say. Secondly, they say that in requesting a stay, AMPCO is asking the Court to exercise a power that it does not have in these circumstances. They point to the fact that the OEB's authority to review the IESO rules is entirely statutory and argue that if the IESO rule meets the statutory requirements, the OEB's review is complete.

22 Finally, CORAL and TEL say that an application for an OEG review of an amendment does not stay the amendment unless the Board, itself, orders a stay pending its review of the amendment. Here the Board lifted the earlier stay, pending its Decision, and therefore, CORAL and TEL say, I should not consider the stay.

23 I am not, however, convinced that the issues in question are so serious that a stay should be granted, pending Appeal. Nor am I satisfied that a strong case for a stay has been made out by AMPCO. See: *Ontario (Minister of Natural Resources) v. Mosher* (2003), 41 C.P.C. (5th) 66 (Ont. C.A.) at para. 7. Even if I am wrong in this regard, AMPCO still must meet the other two branches of the test.

  

***(b) At the second stage of the test, the applicant is required to demonstrate that irreparable harm will result if the relief is not granted.***

24 The question of what is irreparable harm and its effect, has been analyzed in *Operation Dismantle Inc. v. R.*, [1985] 1 S.C.R. 441, 18 D.L.R. (4th) 481, 12 Admin. L.R. 16, 13 C.R.R. 287 (S.C.C.), 1985 CanLII 74, in which the Court examines the principles as set out in *Injunctions and Specific Performance (1983)* by Professor Robert Sharpe, as he then was. On pp. 30-31, Professor Sharpe (now Sharpe, J.A.) states that all injunctions are future looking in the sense that they are intended to prevent or avoid harm. There can be no evidence as to the nature of the harm, since it has not yet occurred, but there must be a "high degree of probability that the harm will in fact occur."

25 The Board has limited jurisdiction to deal with the Amendment, if it finds it inconsistent with the purposes of the Act or unjustly discriminates against or in favour of a market participant or class of market participants. It may revoke the Amendment or send the Amendment back to the IESO under subsection 33(9)(b) of the *Electricity Act*, which it had the authority to do, after hearing the Application. The Board took neither of these steps. (See: Decision of the Board pp.9-10.)

26 AMPCO says that a refusal to grant the stay could "...so adversely affect AMPCO's interest and that the harm could not be remedied if it is eventually successful on appeal." They say that the term "irreparable" refers to the nature of the harm, rather than its magnitude. It is harm that cannot be compensated for monetarily or, which cannot be cured.

27 As I have noted earlier, AMPCO and the Respondents are very far apart on the monetary impact, which the Amendment will have on users of energy. AMPCO is sure that there will be huge monetary amounts collected under the new ramp rate, whereas the Respondents see any such monetary increase in amounts, if any, as *de minimus.*

28 AMPCO says if such amounts are collected while it waits for the Appeal to be heard, there would be no way of refunding such amounts, if the Appeal is allowed. The Respondents, on the other hand, see this as an unrealistic step, given the way the Market Rate Amendment operates. APPrO says that there are factual findings of the Board, which indicate that this Amendment may benefit electricity consumers and result in a decrease in electricity costs. It sees the harm as arising if the 12x ramp rate multiplier is left in place, if a stay is granted. It says such harm includes, *inter alia*:

> ...increased and uneconomic exports; distortion of price and related market signals; impeding customers from realizing and responding to the true cost of electricity that they consume, prejudicing customers and generators that seek to respond to market signals, diminishing market responsive conservation, and demand management programs; dampening natural volatility and diminishing demand responsiveness.

29 IESO says the 12x ramp rate multiplier was a temporary fix in the first place. It sees the scope of the Board's mandate as much narrower than does AMPCO. The irreparable harm would fall to the Respondents, they say, if such a stay is granted. Even if any such harm does occur, I agree with IESO that it would still not tip the balance in favour of AMPCO. The Board found that the Amendment furthers the objectives of the Act, and it cannot be said on Motion for a stay, that this finding can be ignored in reviewing the issue of harm.

30 CORAL and TEL support the positions of IESO and APPrO on the other two branches of the test, and say that AMPRO has not met those tests either.

31 I find that AMPRO has not met the second branch of the test in proving that it will suffer irreparable harm if the stay is not granted. On the contrary, it is the Respondents who may be harmed if the stay is granted.

***(c) At the third stage of the test, the Court is required to assess the parties' situations to see who the balance of convenience favours.***

32 As for the balance of convenience, I find that it weighs in favour of the public interest as put forward by IESO, and AMPCO. I do not see this as a case where the *status quo* must be preserved, pending the outcome of the Appeal. Nor, is this a

  

Charter case. The IESO is charged, by statute, with making and amending the market rules under the Act. The question then must be asked whether AMPCO has shown whether there are "...public interest benefits which will flow from the granting of the relief sought." That is, is there a public benefit, if a stay is granted? See: *RJR-MacDonald*, *supra.*

33 IESO says there are no such benefits if a stay is granted. On the other hand, the balance favours IESO's position, given that the Board, itself, found the Amendment to be in the public interest. The Board accepted the Respondents' position that the Amendment will lead to "...improvements in the economic efficiency of the electricity system in Ontario", which will "...promote adequacy and reliability of supply by providing more accurate price signals and triggering more appropriate price responsive behaviour."

34 APPrO says that there are "...many and significant negative impacts on Ontario electricity stakeholders, including the consumers and the public", which result from the 12x ramp rate multiplier continuing to be used if the stay is granted. Their interests, they say, are better served by "prompt implementation" of the Market Rage Amendment. The balance of convenience, they say, favours the consumers and public in not granting a stay. I agree with this and hold that the balance of convenience favours the Respondents. AMPCO has not met the third branch of the test.

35 All Respondents say there is urgency to getting the Appeal heard, as noted by the Market Surveillance Panel's report, which was before the Board.

**Conclusion**

36 AMPCO's Motion for a stay of the Board's Decision, is dismissed for the reasons set out herein. If the parties cannot otherwise agree on Costs, the parties may submit brief written submissions to me on such Costs, within 30 days of this Order. Order to go that AMPCO's Appeal be expedited.

**End of Document**

EB-2019-0242
Brief of Authorities to
AMPCO Submissions for Motion for Stay

**TAB B**

*RJR-MacDonald v. Canada (Attorney General),*
*111 D.L.R. (4th) 385 (S.C.C.)*

1994 CarswellQue 120
Supreme Court of Canada

RJR — MacDonald Inc. v. Canada (Attorney General)

1994 CarswellQue 120F, 1994 CarswellQue 120, [1994] 1 S.C.R. 311, [1994] A.C.S. No. 17, [1994] S.C.J. No. 17, 111 D.L.R. (4th) 385, 164 N.R. 1, 46 A.C.W.S. (3d) 40, 54 C.P.R. (3d) 114, 5 W.D.C.P. (2d) 136, 60 Q.A.C. 241, J.E. 94-423, EYB 1994-28671

# RJR — MacDonald Inc., Applicant v. The Attorney General of Canada, Respondent and The Attorney General of Quebec, Mis-en-cause and The Heart and Stroke Foundation of Canada, the Canadian Cancer Society, the Canadian Council on Smoking and Health, and Physicians for a Smoke-Free Canada, Interveners on the application for interlocutory relief

Imperial Tobacco Ltd., Applicant v. The Attorney General of Canada, Respondent and The Attorney General of Quebec, Mis-en-cause and The Heart and Stroke Foundation of Canada, the Canadian Cancer Society, the Canadian Council on Smoking and Health, and Physicians for a Smoke-Free Canada, Interveners on the application for interlocutory relief

Lamer C.J. and La Forest, L'Heureux-Dubé, Sopinka, Gonthier, Cory, McLachlin, Iacobucci and Major JJ.

Judgment: October 4, 1993
Judgment: March 3, 1994
Docket: 23460, 23490

Proceedings: Applications for Interlocutory Relief

Counsel: *Colin K. Irving* , for the applicant RJR — MacDonald Inc.
*Simon V. Potter* , for the applicant Imperial Tobacco Inc.
*Claude Joyal* and *Yves Leboeuf* , for the respondent.
*W. Ian C. Binnie, Q.C.* , and *Colin Baxter* , for the Heart and Stroke Foundation of Canada, the Canadian Cancer Society, the Canadian Council on Smoking and Health, and Physicians for a Smoke-Free Canada.

Subject: Constitutional; Intellectual Property; Civil Practice and Procedure; Public; Property

**Related Abridgment Classifications**

Civil practice and procedure
XXIII Practice on appeal
XXIII.18 Appeal to Supreme Court of Canada
XXIII.18.e Stay pending appeal

Remedies
II Injunctions
II.1 Principles relating to availability of injunctions
II.1.e Public interest

  

Remedies
II Injunctions
II.7 Injunctions in specific contexts
II.7.k Injunctions involving Crown or government entities

Remedies
II Injunctions
II.9 Form and operation of order
II.9.f Stay of injunction
II.9.f.i Pending appeal

**Headnote**

Injunctions --- Injunctions involving Crown — Miscellaneous injunctions

Injunctions --- Availability of injunctions — Public interest

Injunctions --- Availability of injunctions — Need to show irreparable injury

Injunctions --- Availability of injunctions — Interim, interlocutory and permanent injunctions — Balance of convenience — Restraint of governmental acts

Practice --- Practice on appeal — Appeal to Supreme Court of Canada — Stay pending appeal

Jurisdiction of Supreme Court of Canada to stay implementation of regulations pending appeal — Distinction between suspension of and exemption from regulations irrelevant — Tobacco Products Control Act, S.C. 1988, c. 20 — Supreme Court Act, R.S.C. 1985, c. S-26, s. 65.1 — Can R. 27.

Applicants challenged the constitutional validity of the Tobacco Products Control Act, which regulated the advertisement of tobacco products and health warnings on those products. The Court of Appeal found the legislation to be constitutional. Before a decision on applicants' leave applications in the main action was made, applicants applied to the Supreme Court of Canada for a stay from compliance with the new packaging requirements pursuant to s. 65.1 of the Supreme Court Act, or, in the event that leave was granted, pursuant to R. 27. A preliminary issue of jurisdiction was raised. Held, the Court had jurisdiction to grant such relief but the applications for stays were dismissed. The phrase "other relief" in R. 27 was broad enough to permit the Court to defer enforcement of regulations that were not in existence when the appeal judgment was rendered, and could apply even though leave to appeal was not yet granted. S. 65.1 was to be interpreted as conferring the same broad powers as R. 27. The Court had to be able to intervene not only against the direct dictates of a judgment, but also against its effects. Even if the relief requested by applicants was for the suspension of the regulation rather than for an exemption from it, jurisdiction to grant such relief existed, as a distinction between such cases was only to be made after jurisdiction was otherwise established.

Application for stay of compliance with new tobacco packaging regulations — Tobacco Products Control Act, S.C. 1988, c. 20.

Applicants challenged the constitutional validity of the Act, which regulated the advertisement of tobacco products and health warnings on those products. The Court of Appeal found the legislation to be constitutional. Before a decision on applicants' leave applications in the main action was made, applicants applied to the Supreme Court of Canada for a stay from compliance with the new packaging requirements. Held, the applications for stays were dismissed. The same test was to be applied to applications for interlocutory injunctions and stays in both private law and Charter cases. The case clearly raised serious questions of law and the expenditures which the new regulations required would impose irreparable harm on applicants if the stay were denied and the main action were successful. However, in determining the balance of convenience, any economic hardship suffered by applicants could be avoided by passing it on to tobacco purchasers. Public interest had to be taken into account. Public interest consideration carried less weight in exemption cases than in suspension cases, the present case being of the latter type. The only possible public interest in continuing current packaging requirements was that the price of cigarettes for smokers would not increase. This increase would be slight and would carry little weight when

  

balanced against the undeniable public interest in health protection from medical problems attributable to smoking.

Applicants challenged the constitutional validity of the Act, which regulated the advertisement of tobacco products and health warnings on those products. The Court of Appeal found the legislation to be constitutional. Before a decision on applicants' leave applications in the main action was made, applicants applied to the Supreme Court of Canada for a stay from compliance with the new packaging requirements. Held, the applications for stays were dismissed. The same test was to be applied to applications for interlocutory injunctions and stays in both private law and Charter cases. The case clearly raised serious questions of law. Where the government was the unsuccessful party in a constitutional claim, a plaintiff faced a much more difficult task in establishing constitutional liability and obtaining monetary redress. The expenditures which the new regulations required would therefore impose irreparable harm on applicants if the stay were denied and the main action were successful. However, in determining the balance of convenience, any economic hardship suffered by applicants could be avoided by passing it on to tobacco purchasers. The only possible public interest in continuing current packaging requirements was that the price of cigarettes for smokers would not increase. This increase would be slight and would carry little weight when balanced against the undeniable public interest in health protection from medical problems attributable to smoking.

Applicants challenged the constitutional validity of the Act, which regulated the advertisement of tobacco products and health warnings on those products. The Court of Appeal found the legislation to be constitutional. Before a decision on applicants' leave applications in the main action was made, applicants applied to the Supreme Court of Canada for a stay from compliance with the new packaging requirements. Held, the applications for stays were dismissed. The same test was to be applied to applications for interlocutory injunctions and stays in both private law and Charter cases. The case clearly raised serious questions of law and the expenditures which the new regulations required would impose irreparable harm on applicants if the stay were denied and the main action were successful. However, in determining the balance of convenience, any economic hardship suffered by applicants could be avoided by passing it on to tobacco purchasers. The only possible public interest in continuing current packaging requirements was that the price of cigarettes for smokers would not increase. This increase would be slight and would carry little weight when balanced against the undeniable public interest in health protection from medical problems attributable to smoking.

Jurisdiction to stay implementation of regulations pending appeal — Distinction between suspension of and exemption from regulations irrelevant — Tobacco Products Control Act, S.C. 1988, c. 20 — Supreme Court Act, R.S.C. 1985, c. S-26, s. 65.1 — Can. R. 27.

Applicants challenged the constitutional validity of the Tobacco Products Control Act, which regulated the advertisement of tobacco products and health warnings on those products. The Court of Appeal found the legislation to be constitutional. Before a decision on applicants' leave applications in the main action was made, applicants applied to the Supreme Court of Canada for a stay from compliance with the new packaging requirements pursuant to s. 65.1 of the Supreme Court Act or, in the event that leave was granted, pursuant to R. 27. A preliminary issue of jurisdiction was raised. Held, the Court had jurisdiction to grant such relief but the applications for stays were dismissed. The phrase "other relief" in R. 27 was broad enough to permit the Court to defer enforcement of regulations that were not in existence when the appeal judgment was rendered, and could apply even though leave to appeal was not yet granted. S. 65.1 was to be interpreted as conferring the same broad powers as R. 27. The Court had to be able to intervene not only against the direct dictates of a judgment, but also against its effects. Even if the relief requested by applicants was for the suspension of the regulation rather than for an exemption from it, jurisdiction to grant such relief existed, as a distinction between such cases was only to be made after jurisdiction was otherwise established.

**The judgment of the Court on the applications for interlocutory relief was delivered by *Sopinka and Cory JJ.*:**

**I. Factual Background**

1 These applications for relief from compliance with certain *Tobacco Products Control Regulations, amendment* , SOR/93-389 as interlocutory relief are ancillary to a larger challenge to regulatory legislation which will soon be heard by this Court.

  

2 The *Tobacco Products Control Act* , R.S.C., 1985, c. 14 (4th Supp.), S.C. 1988, c. 20, came into force on January 1, 1989. The purpose of the Act is to regulate the advertisement of tobacco products and the health warnings which must be placed upon tobacco products.

3 The first part of the *Tobacco Products Control Act* , particularly ss. 4 to 8, prohibits the advertisement of tobacco products and any other form of activity designed to encourage their sale. Section 9 regulates the labelling of tobacco products, and provides that health messages must be carried on all tobacco packages in accordance with the regulations passed pursuant to the Act.

4 Sections 11 to 16 of the Act deal with enforcement and provide for the designation of tobacco product inspectors who are granted search and seizure powers. Section 17 authorizes the Governor in Council to make regulations under the Act. Section 17(*f* ) authorizes the Governor in Council to adopt regulations prescribing "the content, position, configuration, size and prominence" of the mandatory health messages. Section 18(1)(*b* ) of the Act indicates that infringements may be prosecuted by indictment, and upon conviction provides for a penalty by way of a fine not to exceed $100,000, imprisonment for up to one year, or both.

5 Each of the applicants challenged the constitutional validity of the *Tobacco Products Control Act* on the grounds that it is *ultra vires* the Parliament of Canada and invalid as it violates s. 2(*b* ) of the *Canadian Charter of Rights and Freedoms* . The two cases were heard together and decided on common evidence.

6 On July 26, 1991, Chabot J. of the Quebec Superior Court granted the applicants' motions, [1991] R.J.Q. 2260, 82 D.L.R. (4th) 449 , finding that the Act was *ultra vires* the Parliament of Canada and that it contravened the *Charter* . The respondent appealed to the Quebec Court of Appeal. Before the Court of Appeal rendered judgment, the applicants applied to this court for interlocutory relief in the form of an order that they would not have to comply with certain provisions of the Act for a period of 60 days following judgment in the Court of Appeal.

7 Up to that point, the applicants had complied with all provisions in the *Tobacco Products Control Act* . However, under the Act, the complete prohibition on all point of sale advertising was not due to come into force until December 31, 1992. The applicants estimated that it would take them approximately 60 days to dismantle all of their advertising displays in stores. They argued that, with the benefit of a Superior Court judgment declaring the Act unconstitutional, they should not be required to take any steps to dismantle their displays until such time as the Court of Appeal might eventually hold the legislation to be valid. On the motion the Court of Appeal held that the penalties for non-compliance with the ban on point of sale advertising could not be enforced against the applicants until such time as the Court of Appeal had released its decision on the merits. The court refused, however, to stay the enforcement of the provisions for a period of 60 days following a judgment validating the Act.

8 On January 15, 1993, the Court of Appeal for Quebec, [1993] R.J.Q. 375, 102 D.L.R. (4th) 289 , allowed the respondent's appeal, Brossard J.A. dissenting in part. The Court unanimously held that the Act was not *ultra vires* the government of Canada. The Court of Appeal accepted that the Act infringed s. 2(*b* ) of the *Charter* but found, Brossard J.A. dissenting on this aspect, that it was justified under s. 1 of the *Charter* . Brossard J.A. agreed with the majority with respect to the requirement of unattributed package warnings (that is to say the warning was not to be attributed to the Federal Government) but found that the ban on advertising was not justified under s. 1 of the *Charter* . The applicants filed an application for leave to appeal the judgment of the Quebec Court of Appeal to this Court.

9 On August 11, 1993, the Governor in Council published amendments to the regulations dated July 21, 1993, under the Act: *Tobacco Products Control Regulations, amendment* , SOR/93-389. The amendments stipulate that larger, more prominent health warnings must be placed on all tobacco products packets, and that these warnings can no longer be attributed to Health and Welfare Canada. The packaging changes must be in effect within one year.

10 According to affidavits filed in support of the applicant's motion, compliance with the new regulations would require the tobacco industry to redesign all of its packaging and to purchase thousands of rotograve cylinders and embossing dies. These changes would take close to a year to effect, at a cost to the industry of about $30,000,000.

 

11 Before a decision on their leave applications in the main actions had been made, the applicants brought these motions for a stay pursuant to s. 65.1 of the *Supreme Court Act* , R.S.C., 1985, c. S-26 (ad. by S.C. 1990, c. 8, s. 40) or, in the event that leave was granted, pursuant to r. 27 of the *Rules of the Supreme Court of Canada* , SOR/83-74. The applicants seek to stay "the judgment of the Quebec Court of Appeal delivered on January 15, 1993", but "only insofar as that judgment validates sections 3, 4, 5, 6, 7 and 10 of [the new regulations]". In effect, the applicants ask to be released from any obligation to comply with the new packaging requirements until the disposition of the main actions. The applicants further request that the stays be granted for a period of 12 months from the dismissal of the leave applications or from a decision of this Court confirming the validity of *Tobacco Products Control Act* .

12 The applicants contend that the stays requested are necessary to prevent their being required to incur considerable irrecoverable expenses as a result of the new regulations even though this Court may eventually find the enabling legislation to be constitutionally invalid.

13 The applicants' motions were heard by this Court on October 4. Leave to appeal the main actions was granted on October 14.

**II. Relevant Statutory Provisions**

***Tobacco Products Control Act, R.S.C., 1985, c. 14 (4th Supp.), S.C. 1988, c. 20, s. 3:***

14

> *3.* The purpose of this Act is to provide a legislative response to a national public health problem of substantial and pressing concern and, in particular,
>
> (*a* ) to protect the health of Canadians in the light of conclusive evidence implicating tobacco use in the incidence of numerous debilitating and fatal diseases;
>
> (*b* ) to protect young persons and others, to the extent that is reasonable in a free and democratic society, from inducements to use tobacco products and consequent dependence on them; and
>
> (*c* ) to enhance public awareness of the hazards of tobacco use by ensuring the effective communication of pertinent information to consumers of tobacco products.

***Supreme Court Act, R.S.C., 1985, c. S-26, s. 65.1 (ad. S.C. 1990, c. 8, s. 40):***

15

> *65.1* The Court or a judge may, on the request of a party who has filed a notice of application for leave to appeal, order that proceedings be stayed with respect to the judgment from which leave to appeal is being sought, on such terms as to the Court or the judge seem just.

***Rules of the Supreme Court of Canada, SOR/83-74, s. 27:***

16

> 27. Any party against whom judgment has been given, or an order made, by the Court or any other court, may apply to the Court for a stay of execution or other relief against such a judgment or order, and the Court may give such relief upon such terms as may be just.

 

**III. Courts Below**

17 In order to place the applications for the stay in context it is necessary to review briefly the decisions of the courts below.

***Superior Court, [1991] R.J.Q. 2260, 82 D.L.R. (4th) 449***

18 Chabot J. concluded that the dominant characteristic of the *Tobacco Products Control Act* was the control of tobacco advertising and that the protection of public health was only an incidental objective of the Act. Chabot J. characterized the *Tobacco Products Control Act* as a law regulating advertising of a particular product, a matter within provincial legislative competence.

19 Chabot J. found that, with respect to s. 2(*b* ) of the *Charter* , the activity prohibited by the Act was a protected activity, and that the notices required by the Regulations violated that *Charter* guarantee. He further held that the evidence demonstrated that the objective of reducing the level of consumption of tobacco products was of sufficient importance to warrant legislation restricting freedom of expression, and that the legislative objectives identified by Parliament to reduce tobacco use were a pressing and substantial concern in a free and democratic society.

20 However, in his view, the Act did not minimally impair freedom of expression, as it did not restrict itself to protecting young people from inducements to smoke, or limit itself to lifestyle advertising. Chabot J. found that the evidence submitted by the respondent in support of its contention that adver tising bans decrease consumption was unreliable and without probative value because it failed to demonstrate that any ban of tobacco advertising would be likely to bring about a reduction of tobacco consumption. Therefore, the respondent had not demonstrated that an advertising ban restricted freedom of expression as little as possible. Chabot J. further concluded that the evidence of a rational connection between the ban of Canadian advertising and the objective of reducing overall consumption of tobacco was deficient, if not non-existent. He held that the Act was a form of censorship and social engineering which was incompatible with a free and democratic society and could not be justified.

***Court of Appeal (on the application for a stay)***

21 In deciding whether or not to exercise its broad power under art. 523 of the *Code of Civil Procedure of Québec* to "make any order necessary to safeguard the rights of the parties", the Court of Appeal made the following observation on the nature of the relief requested:

> But what is at issue here (if the Act is found to be constitutionally valid) is the suspension of the legal effect of part of the Act and the legal duty to comply with it for 60 days, and the suspension, as well, of the power of the appropriate public authorities to enforce the Act. To suspend or delay the effect or the enforcement of a *valid* act of the legislature, particularly one purporting to relate to the protection of public health or safety is a serious matter. The courts should not lightly limit or delay the implementation or enforcement of *valid* legislation where the legislature has brought that legislation into effect. To do so would be to intrude into the legislative and the executive spheres. [Emphasis in original.]

The Court made a partial grant of the relief sought as follows:

> Since the letters of the Department of Health and Welfare and appellants' contestation both suggest the possibility that the applicants may be prosecuted under *Sec. 5* after December 31, 1992 whether or not judgment has been rendered on these appeals by that date, it seems reasonable to order the suspension of enforcement under *Sec. 5* of the Act until judgment has been rendered by this Court on the present appeals. There is, after all, a serious issue as to the validity of the Act, and it would be unfairly onerous to require the applicants to incur substantial expense in dismantling these point of sale displays until we have resolved that issue.
>
> We see no basis, however, for ordering a stay of the coming into effect of the Act for 60 days following our judgment on

  

> the appeals.
>
> . . . . .
>
> Indeed, given the public interest aspect of the Act, which purports to be concerned with the protection of public health, if the Act were found to be valid, there is excellent reason why its effect and enforcement should not be suspended (*A.G. of Manitoba v. Metropolitan Stores (MTS) Ltd.*, [1987] 1 S.C.R. 110 , 127, 135). [Emphasis in original.]

***Court of Appeal (on the validity of the legislation), [1993] R.J.Q. 375, 102 D.L.R. (4th) 289***

*1. LeBel J.A. (for the majority)*

22 LeBel J.A. characterized the *Tobacco Products Control Act* as legislation relating to public health. He also found that it was valid as legislation enacted for the peace, order and good government of Canada.

23 LeBel J.A. applied the criteria set out in *R. v. Crown Zellerbach Canada Ltd.*, [1988] 1 S.C.R. 401 , and concluded that the Act satisfied the "national concern" test and could properly rest on a purely theoretical, unproven link between tobacco advertising and the overall consumption of tobacco.

24 LeBel J.A. agreed with Brossard J.A. that the Act infringed freedom of expression pursuant to s. 2(*b* ) of the *Charter* but found that it was justified under s. 1 of the *Charter* . LeBel J.A. concluded that Chabot J. erred in his findings of fact in failing to recognize that the rational connection and minimal impairment branches of the *Oakes* test have been attenuated by later decisions of the Supreme Court of Canada. He found that the s. 1 test was satisfied since there was a possibility that prohibiting tobacco advertising might lead to a reduction in tobacco consumption, based on the mere existence of a [Translation] "body of opinion" favourable to the adoption of a ban. Further he found that the Act appeared to be consistent with minimal impairment as it did not prohibit consumption, did not prohibit foreign advertising and did not preclude the possibility of obtaining information about tobacco products.

*2. Brossard J.A. (dissenting in part)*

25 Brossard J.A. agreed with LeBel J.A. that the *Tobacco Products Control Act* should be characterized as public health legislation and that the Act satisfied the "national concern" branch of the peace, order and good government power.

26 However, he did not think that the violation of s. 2(*b* ) of the *Charter* could be justified. He reviewed the evidence and found that it did not demonstrate the existence of a connection or even the possibility of a connection between an advertising ban and the use of tobacco. It was his opinion that it must be shown on a balance of probabilities that it was at least possible that the goals sought would be achieved. He also disagreed that the Act met the minimal impairment requirement since in his view the Act's objectives could be met by restricting advertising without the need for a total prohibition.

**IV. Jurisdiction**

27 A preliminary question was raised as to this Court's jurisdiction to grant the relief requested by the applicants. Both the Attorney General of Canada and the interveners on the stay (several health organizations, i.e., the Heart and Stroke Foundation of Canada, the Canadian Cancer Society, the Canadian Council on Smoking and Health, and Physicians for a Smoke-Free Canada) argued that this Court lacks jurisdiction to order a stay of execution or of the proceedings which would relieve the applicants of the obligation of complying with the new regulations. Several arguments were advanced in support of this position.

28 First, the Attorney General argued that neither the old nor the new regulations dealing with the health messages were in issue before the lower courts and, as such, the applicants' requests for a stay truly cloaks requests to have this Court exercise an original jurisdiction over the matter. Second, he contended that the judgment of the Quebec Court of Appeal is not subject to execution given that it only declared that the Act was *intra vires* s. 91 of the *Constitution Act, 1867* and justified under s. 1 of the *Charter* . Because the lower court decision amounts to a declaration, there is, therefore, no

  

"proceeding" that can be stayed. Finally, the Attorney General characterized the applicants' requests as being requests for a suspension by anticipation of the 12-month delay in which the new regulations will become effective so that the applicants can continue to sell tobacco products for an extended period in packages containing the health warnings required by the present regulations. He claimed that this Court has no jurisdiction to suspend the operation of the new regulations.

29 The interveners supported and elaborated on these submissions. They also submitted that r. 27 could not apply because leave to appeal had not been granted. In any event, they argued that the words "or other relief" are not broad enough to permit this Court to defer enforcement of regulations that were not even in existence at the time the appeal judgment was rendered.

30 The powers of the Supreme Court of Canada to grant relief in this kind of proceeding are contained in s. 65.1 of the *Supreme Court Act* and r. 27 of the *Rules of the Supreme Court of Canada* .

***Supreme Court Act***

31

> *65.1* The Court or a judge may, on the request of a party who has filed a notice of application for leave to appeal, order that proceedings be stayed with respect to the judgment from which leave to appeal is being sought, on such terms as to the Court or the judge seem just.

***Rules of the Supreme Court of Canada***

32

> 27. Any party against whom judgment has been given, or an order made, by the Court or any other court, may apply to the Court for a stay of execution or other relief against such a judgment or order, and the Court may give such relief upon such terms as may be just.

33 Rule 27 and its predecessor have existed in substantially the same form since at least 1888 (see *Rules of the Supreme Court of Canada* , 1888, General Order No. 85(17)). Its broad language reflects the language of s. 97 of the Act whence the Court derives its rule-making power. Subsection (1)(*a* ) of that section provides that the rules may be enacted:

> *97.* ...
>
> > (*a* ) for regulating the procedure of and in the Court and the bringing of cases before it from courts appealed from or otherwise, and for the effectual execution and working of this Act and the attainment of the intention and objects thereof;

Although the point is now academic, leave to appeal having been granted, we would not read into the rule the limitations suggested by the interveners. Neither the words of the rule nor s. 97 contain such limitations. In our opinion, in interpreting the language of the rule, regard should be had to its purpose, which is best expressed in the terms of the empowering section: to facilitate the "bringing of cases" before the Court "for the effectual execution and working of this Act". To achieve its purpose the rule can neither be limited to cases in which leave to appeal has already been granted nor be interpreted narrowly to apply only to an order stopping or arresting execution of the Court's process by a third party or freezing the judicial proceeding which is the subject matter of the judgment in appeal. Examples of the former, traditionally described as stays of execution, are contained in the subsections of s. 65 of the Act which have been held to be limited to preventing the intervention of a third party such as a sheriff but not the enforcement of an order directed to a party. See *Keable v. Attorney General (Can.)*, [1978] 2 S.C.R. 135 . The stopping or freezing of all proceedings is traditionally referred to as a stay of proceedings. See *Battle Creek Toasted Corn Flake Co. v. Kellogg Toasted Corn Flake Co.* (1924), 55 O.L.R. 127 (C.A.) . Such relief can be granted pursuant to this Court's powers in r. 27 or s. 65.1 of the Act.

 

34 Moreover, we cannot agree that the adoption of s. 65.1 in 1992 (S.C. 1990, c. 8, s. 40) was intended to limit the Court's powers under r. 27. The purpose of that amendment was to enable a single judge to exercise the jurisdiction to grant stays in circumstances in which, before the amendment, a stay could be granted by the Court. Section 65.1 should, therefore, be interpreted to confer the same broad powers that are included in r. 27.

35 In light of the foregoing and bearing in mind in particular the language of s. 97 of the Act we cannot agree with the first two points raised by the Attorney General that this Court is unable to grant a stay as requested by the applicants. We are of the view that the Court is empowered, pursuant to both s. 65.1 and r. 27, not only to grant a stay of execution and of proceedings in the traditional sense, but also to make any order that preserves matters between the parties in a state that will prevent prejudice as far as possible pending resolution by the Court of the controversy, so as to enable the Court to render a meaningful and effective judgment. The Court must be able to intervene not only against the direct dictates of the judgment but also against its effects. This means that the Court must have jurisdiction to enjoin conduct on the part of a party in reliance on the judgment which, if carried out, would tend to negate or diminish the effect of the judgment of this Court. In this case, the new regulations constitute conduct under a law that has been declared constitutional by the lower courts.

36 This, in our opinion, is the view taken by this Court in *Labatt Breweries of Canada Ltd. v. Attorney General of Canada*, [1980] 1 S.C.R. 594 . The appellant Labatt, in circumstances similar to those in this case, sought to suspend enforcement of regulations which were attacked by it in an action for a declaration that the regulations were inapplicable to Labatt's product. The Federal Court of Appeal reversed a lower court finding in favour of Labatt. Labatt applied for a stay pending an appeal to this Court. Although the parties had apparently agreed to the terms of an order suspending further proceedings, Laskin C.J. dealt with the issue of jurisdiction, an issue that apparently was contested notwithstanding the agreement. The Chief Justice, speaking for the Court, determined that the Court was empowered to make an order suspending the enforcement of the impugned regulation by the Department of Consumer and Corporate Affairs. At page 600, Laskin C.J. responded as follows to arguments advanced on the traditional approach to the power to grant a stay:

> It was contended that the Rule relates to judgments or orders of this Court and not to judgments or orders of the Court appealed from. Its formulation appears to me to be inconsistent with such a limitation. Nor do I think that the position of the respondent that there is no judgment against the appellant to be stayed is a tenable one. Even if it be so, there is certainly an order against the appellant. *Moreover, I do not think that the words of Rule 126, authorizing this Court to grant relief against an adverse order, should be read so narrowly as to invite only intervention directly against the order and not against its effect while an appeal against it is pending in this Court.* I am of the opinion, therefore, that the appellant is entitled to apply for interlocutory relief against the operation of the order dismissing its declaratory action, and that this Court may grant relief on such terms as may be just. [Emphasis added.]

37 While the above passage appears to answer the submission of the respondents on this motion that *Labatt* was distinguishable because the Court acted on a consent order, the matter was put beyond doubt by the following additional statement of Laskin C.J. at p. 601:

> Although I am of the opinion that Rule 126 applies to support the making of an order of the kind here agreed to by counsel for the parties, I would not wish it to be taken that this Court is otherwise without power to prevent proceedings pending before it from being aborted by unilateral action by one of the parties pending final determination of an appeal.

Indeed, an examination of the factums filed by the parties to the motion in *Labatt* reveals that while it was agreed that the dispute would be resolved by an application for a declaration, it was not agreed that pending resolution of the dispute the enforcement of the regulations would be stayed.

38 In our view, this Court has jurisdiction to grant the relief requested by the applicants. This is the case even if the applicants' requests for relief are for "suspension" of the regulation rather than "exemption" from it. To hold otherwise would be inconsistent with this Court's finding in *Manitoba (Attorney General) v. Metropolitan Stores (MTS) Ltd.*, [1987] 1 S.C.R. 110 . In that case, the distinction between "suspension" and "exemption" cases is made only after jurisdiction has been otherwise established and the public interest is being weighed against the interests of the applicant seeking the stay of proceedings. While "suspension" is a power that, as is stressed below, must be exercised sparingly, this is achieved by applying the criteria in *Metropolitan Stores* strictly and not by a restrictive interpretation of this Court's jurisdiction. Therefore, the final argument of the Attorney General on the issue of jurisdiction also fails.

 

39 Finally, if jurisdiction under s. 65.1 of the Act and r. 27 were wanting, we would be prepared to find jurisdiction in s. 24(1) of the *Charter* . A *Charter* remedy should not be defeated due to a deficiency in the ancillary procedural powers of the Court to preserve the rights of the parties pending a final resolution of constitutional rights.

**V. Grounds for Stay of Proceedings**

40 The applicants rely upon the following grounds:

1. The challenged *Tobacco Products Control Regulations, amendment* were promulgated pursuant to ss. 9 and 17 of the *Tobacco Products Control Act* , S.C. 1988, c. 20.

2. The applicants have applied to this Court for leave to appeal a judgment of the Quebec Court of Appeal dated January 15, 1993. The Court of Appeal overturned a decision of the Quebec Superior Court declaring certain sections of the Act to be beyond the powers of the Parliament of Canada and an unjustifiable violation of the *Canadian Charter of Rights and Freedoms* .

3. The effect of the new regulations is such that the applicants will be obliged to incur substantial unrecoverable expenses in carrying out a complete redesign of all its packaging before this Court will have ruled on the constitutional validity of the enabling legislation and, if this Court restores the judgment of the Superior Court, will incur the same expenses a second time should they wish to restore their packages to the present design.

4. The tests for granting of a stay are met in this case:

(i) There is a serious constitutional issue to be determined.

(ii) Compliance with the new regulations will cause irreparable harm.

(iii) The balance of convenience, taking into account the public interest, favours retaining the status quo until this court has disposed of the legal issues.

**VI. Analysis**

41 The primary issue to be decided on these motions is whether the applicants should be granted the interlocutory relief they seek. The applicants are only entitled to this relief if they can satisfy the test laid down in *Manitoba (Attorney General) v. Metropolitan Stores (MTS) Ltd., supra* . If not, the applicants will have to comply with the new regulations, at least until such time as a decision is rendered in the main actions.

***A. Interlocutory Injunctions, Stays of Proceedings and the Charter***

42 The applicants ask this Court to delay the legal effect of regulations which have already been enacted and to prevent public authorities from enforcing them. They further seek to be protected from enforcement of the regulations for a 12-month period even if the enabling legislation is eventually found to be constitutionally valid. The relief sought is significant and its effects far reaching. A careful balancing process must be undertaken.

43 On one hand, courts must be sensitive to and cautious of making rulings which deprive legislation enacted by elected officials of its effect.

44 On the other hand, the *Charter* charges the courts with the responsibility of safeguarding fundamental rights. For the courts to insist rigidly that all legislation be enforced to the letter until the moment that it is struck down as unconstitutional might in some instances be to condone the most blatant violation of *Charter* rights. Such a practice would undermine the

  

spirit and purpose of the *Charter* and might encourage a government to prolong unduly final resolution of the dispute.

45 Are there, then, special considerations or tests which must be applied by the courts when *Charter* violations are alleged and the interim relief which is sought involves the execution and enforceability of legislation?

46 Generally, the same principles should be applied by a court whether the remedy sought is an injunction or a stay. In *Metropolitan Stores* , at p. 127, Beetz J. expressed the position in these words:

> A stay of proceedings and an interlocutory injunction are remedies of the same nature. In the absence of a different test prescribed by statute, they have sufficient characteristics in common to be governed by the same rules and the courts have rightly tended to apply to the granting of interlocutory stay the principles which they follow with respect to interlocutory injunctions.

47 We would add only that here the applicants are requesting both interlocutory (pending disposition of the appeal) and interim (for a period of one year following such disposition) relief. We will use the broader term "interlocutory relief" to describe the hybrid nature of the relief sought. The same principles apply to both forms of relief.

48 *Metropolitan Stores* adopted a three-stage test for courts to apply when considering an application for either a stay or an interlocutory injunction. First, a preliminary assessment must be made of the merits of the case to ensure that there is a serious question to be tried. Secondly, it must be determined whether the applicant would suffer irreparable harm if the application were refused. Finally, an assessment must be made as to which of the parties would suffer greater harm from the granting or refusal of the remedy pending a decision on the merits. It may be helpful to consider each aspect of the test and then apply it to the facts presented in these cases.

***B. The Strength of the Plaintiff's Case***

49 Prior to the decision of the House of Lords in *American Cyanamid Co. v. Ethicon Ltd.*, [1975] A.C. 396 , an applicant for interlocutory relief was required to demonstrate a "strong *prima facie* case" on the merits in order to satisfy the first test. In *American Cyanamid* , however, Lord Diplock stated that an applicant need no longer demonstrate a strong *prima facie* case. Rather it would suffice if he or she could satisfy the court that "the claim is not frivolous or vexatious; in other words, that there is a serious question to be tried". The *American Cyanamid* standard is now generally accepted by the Canadian courts, subject to the occasional reversion to a stricter standard: see Robert J. Sharpe, *Injunctions and Specific Performance* (2nd ed. 1992), at pp. 2-13 to 2-20.

50 In *Metropolitan Stores* , Beetz J. advanced several reasons why the *American Cyanamid* test rather than any more stringent review of the merits is appropriate in *Charter* cases. These included the difficulties involved in deciding complex factual and legal issues based upon the limited evidence available in an interlocutory proceeding, the impracticality of undertaking a s. 1 analysis at that stage, and the risk that a tentative determination on the merits would be made in the absence of complete pleadings or prior to the notification of any Attorneys General.

51 The respondent here raised the possibility that the current status of the main action required the applicants to demonstrate something more than "a serious question to be tried." The respondent relied upon the following *dicta* of this Court in *Laboratoire Pentagone Ltée v. Parke, Davis & Co.*, [1968] S.C.R. 269 , at p. 272:

> The burden upon the appellant is much greater than it would be if the injunction were interlocutory. In such a case the Court must consider the balance of convenience as between the parties, because the matter has not yet come to trial. In the present case we are being asked to suspend the operation of a judgment of the Court of Appeal, delivered after full consideration of the merits. It is not sufficient to justify such an order being made to urge that the impact of the injunction upon the appellant would be greater than the impact of its suspension upon the respondent.

To the same effect were the comments of Kelly J.A. in *Adrian Messenger Services v. The Jockey Club Ltd. (No. 2)* (1972), 2 O.R. 619 (C.A.) , at p. 620:

 

> Unlike the situation prevailing before trial, where the competing allegations of the parties are unresolved, on an application for an interim injunction pending an appeal from the dismissal of the action the defendant has a judgment of the Court in its favour. Even conceding the ever-present possibility of the reversal of that judgment on appeal, it will in my view be in a comparatively rare case that the Court will interfere to confer upon a plaintiff, even on an interim basis, the very right to which the trial Court has held he is not entitled.

And, most recently, of Philp J. in *Bear Island Foundation v. Ontario* (1989), 70 O.R. (2d) 574 (H.C.) , at p. 576:

> While I accept that the issue of title to these lands is a serious issue, it has been resolved by trial and by appeal. The reason for the Supreme Court of Canada granting leave is unknown and will not be known until they hear the appeal and render judgment. There is not before me at this time, therefore, a serious or substantial issue to be tried. It has already been tried and appealed. No attempt to stop harvesting was made by the present plaintiffs before trial, nor before the appeal before the Court of Appeal of Ontario. The issue is no longer an issue at trial.

52 According to the respondent, such statements suggest that once a decision has been rendered on the merits at trial, either the burden upon an applicant for interlocutory relief increases, or the applicant can no longer obtain such relief. While it might be possible to distinguish the above authorities on the basis that in the present case the trial judge agreed with the applicant's position, it is not necessary to do so. Whether or not these statements reflect the state of the law in private applications for interlocutory relief, which may well be open to question, they have no application in *Charter* cases.

53 The *Charter* protects fundamental rights and freedoms. The importance of the interests which, the applicants allege, have been adversely affected require every court faced with an alleged *Charter* violation to review the matter carefully. This is so even when other courts have concluded that no *Charter* breach has occurred. Furthermore, the complex nature of most constitutional rights means that a motions court will rarely have the time to engage in the requisite extensive analysis of the merits of the applicant's claim. This is true of any application for interlocutory relief whether or not a trial has been conducted. It follows that we are in complete agreement with the conclusion of Beetz J. in *Metropolitan Stores* , at p. 128, that "the *American Cyanamid* 'serious question' formulation is sufficient in a constitutional case where, as indicated below in these reasons, the public interest is taken into consideration in the balance of convenience."

54 What then are the indicators of "a serious question to be tried"? There are no specific requirements which must be met in order to satisfy this test. The threshold is a low one. The judge on the application must make a preliminary assessment of the merits of the case. The decision of a lower court judge on the merits of the *Charter* claim is a relevant but not necessarily conclusive indication that the issues raised in an appeal are serious: see *Metropolitan Stores, supra* , at p. 150. Similarly, a decision by an appellate court to grant leave on the merits indicates that serious questions are raised, but a refusal of leave in a case which raises the same issues cannot automatically be taken as an indication of the lack of strength of the merits.

55 Once satisfied that the application is neither vexatious nor frivolous, the motions judge should proceed to consider the second and third tests, even if of the opinion that the plaintiff is unlikely to succeed at trial. A prolonged examination of the merits is generally neither necessary nor desirable.

56 Two exceptions apply to the general rule that a judge should not engage in an extensive review of the merits. The first arises when the result of the interlocutory motion will in effect amount to a final determination of the action. This will be the case either when the right which the applicant seeks to protect can only be exercised immediately or not at all, or when the result of the application will impose such hardship on one party as to remove any potential benefit from proceeding to trial. Indeed Lord Diplock modified the *American Cyanamid* principle in such a situation in *N.W.L. Ltd. v. Woods*, [1979] 1 W.L.R. 1294 , at p. 1307:

> Where, however, the grant or refusal of the interlocutory injunction will have the practical effect of putting an end to the action because the harm that will have been already caused to the losing party by its grant or its refusal is complete and of a kind for which money cannot constitute any worthwhile recompense, the degree of likelihood that the plaintiff would have succeeded in establishing his right to an injunction if the action had gone to trial is a factor to be brought into the balance by the judge in weighing the risks that injustice may result from his deciding the application one way rather than the other.

 

Cases in which the applicant seeks to restrain picketing may well fall within the scope of this exception. Several cases indicate that this exception is already applied to some extent in Canada.

57 In *Trieger v. Canadian Broadcasting Corp.* (1988), 54 D.L.R. (4th) 143 (Ont. H.C.) , the leader of the Green Party applied for an interlocutory mandatory injunction allowing him to participate in a party leaders' debate to be televised within a few days of the hearing. The applicant's only real interest was in being permitted to participate in the debate, not in any subsequent declaration of his rights. Campbell J. refused the application, stating at p. 152:

> This is not the sort of relief that should be granted on an interlocutory application of this kind. The legal issues involved are complex and I am not satisfied that the applicant has demonstrated there is a serious issue to be tried *in the sense of a case with enough legal merit* to justify the extraordinary intervention of this court in making the order sought without any trial at all. [Emphasis added.]

58 In *Tremblay v. Daigle*, [1989] 2 S.C.R. 530 , the appellant Daigle was appealing an interlocutory injunction granted by the Quebec Superior Court enjoining her from having an abortion. In view of the advanced state of the appellant's pregnancy, this Court went beyond the issue of whether or not the interlocutory injunction should be discharged and immediately rendered a decision on the merits of the case.

59 The circumstances in which this exception will apply are rare. When it does, a more extensive review of the merits of the case must be undertaken. Then when the second and third stages of the test are considered and applied the anticipated result on the merits should be borne in mind.

60 The second exception to the *American Cyanamid* prohibition on an extensive review of the merits arises when the question of constitutionality presents itself as a simple question of law alone. This was recognized by Beetz J. in *Metropolitan Stores* , at p. 133:

> There may be rare cases where the question of constitutionality will present itself as a simple question of law alone which can be finally settled by a motion judge. A theoretical example which comes to mind is one where Parliament or a legislature would purport to pass a law imposing the beliefs of a state religion. Such a law would violate s. 2(*a* ) of the *Canadian Charter of Rights and Freedoms* , could not possibly be saved under s. 1 of the *Charter* and might perhaps be struck down right away; see *Attorney General of Quebec v. Quebec Association of Protestant School Boards*, [1984] 2 S.C.R. 66 , at p. 88. It is trite to say that these cases are exceptional.

A judge faced with an application which falls within the extremely narrow confines of this second exception need not consider the second or third tests since the existence of irreparable harm or the location of the balance of convenience are irrelevant inasmuch as the constitutional issue is finally determined and a stay is unnecessary.

61 The suggestion has been made in the private law context that a third exception to the *American Cyanamid* "serious question to be tried" standard should be recognized in cases where the factual record is largely settled prior to the application being made. Thus in *Dialadex Communications Inc. v. Crammond* (1987), 34 D.L.R. (4th) 392 (Ont. H.C.) , at p. 396, it was held that:

> Where the facts are not substantially in dispute, the plaintiffs must be able to establish a strong *prima facie* case and must show that they will suffer irreparable harm if the injunction is not granted. If there are facts in dispute, a lesser standard must be met. In that case, the plaintiffs must show that their case is not a frivolous one and there is a substantial question to be tried, and that, on the balance of convenience, an injunction should be granted.

To the extent that this exception exists at all, it should not be applied in *Charter* cases. Even if the facts upon which the *Charter* breach is alleged are not in dispute, all of the evidence upon which the s. 1 issue must be decided may not be before the motions court. Furthermore, at this stage an appellate court will not normally have the time to consider even a complete factual record properly. It follows that a motions court should not attempt to undertake the careful analysis required for a consideration of s. 1 in an interlocutory proceeding.

***C. Irreparable Harm***

  

62 Beetz J. determined in *Metropolitan Stores* , at p. 128, that "[t]he second test consists in deciding whether the litigant who seeks the interlocutory injunction would, unless the injunction is granted, suffer irreparable harm". The harm which might be suffered by the respondent, should the relief sought be granted, has been considered by some courts at this stage. We are of the opinion that this is more appropriately dealt with in the third part of the analysis. Any alleged harm to the public interest should also be considered at that stage.

63 At this stage the only issue to be decided is whether a refusal to grant relief could so adversely affect the applicants' own interests that the harm could not be remedied if the eventual decision on the merits does not accord with the result of the interlocutory application.

64 "Irreparable" refers to the nature of the harm suffered rather than its magnitude. It is harm which either cannot be quantified in monetary terms or which cannot be cured, usually because one party cannot collect damages from the other. Examples of the former include instances where one party will be put out of business by the court's decision (*R.L. Crain Inc. v. Hendry* (1988), 48 D.L.R. (4th) 228 (Sask. Q.B.) ); where one party will suffer permanent market loss or irrevocable damage to its business reputation (*American Cyanamid, supra* ); or where a permanent loss of natural resources will be the result when a challenged activity is not enjoined (*MacMillan Bloedel Ltd. v. Mullin*, [1985] 3 W.W.R. 577 (B.C.C.A.) ). The fact that one party may be impecunious does not automatically determine the application in favour of the other party who will not ultimately be able to collect damages, although it may be a relevant consideration (*Hubbard v. Pitt*, [1976] Q.B. 142 (C.A.) ).

65 The assessment of irreparable harm in interlocutory applications involving *Charter* rights is a task which will often be more difficult than a comparable assessment in a private law application. One reason for this is that the notion of irreparable harm is closely tied to the remedy of damages, but damages are not the primary remedy in *Charter* cases.

66 This Court has on several occasions accepted the principle that damages may be awarded for a breach of *Charter* rights: (see, for example, *Mills v. The Queen*, [1986] 1 S.C.R. 863 , at pp. 883, 886, 943 and 971; *Nelles v. Ontario*, [1989] 2 S.C.R. 170 , at p. 196). However, no body of jurisprudence has yet developed in respect of the principles which might govern the award of damages under s. 24(1) of the *Charter* . In light of the uncertain state of the law regarding the award of damages for a *Charter* breach, it will in most cases be impossible for a judge on an interlocutory application to determine whether adequate compensation could ever be obtained at trial. Therefore, until the law in this area has developed further, it is appropriate to assume that the financial damage which will be suffered by an applicant following a refusal of relief, even though capable of quantification, constitutes irreparable harm.

***D. The Balance of Inconvenience and Public Interest Considerations***

67 The third test to be applied in an application for interlocutory relief was described by Beetz J. in *Metropolitan Stores* at p. 129 as: "a determination of which of the two parties will suffer the greater harm from the granting or refusal of an interlocutory injunction, pending a decision on the merits". In light of the relatively low threshold of the first test and the difficulties in applying the test of irreparable harm in *Charter* cases, many interlocutory proceedings will be determined at this stage.

68 The factors which must be considered in assessing the "balance of inconvenience" are numerous and will vary in each individual case. In *American Cyanamid* , Lord Diplock cautioned, at p. 408, that:

> [i]t would be unwise to attempt even to list all the various matters which may need to be taken into consideration in deciding where the balance lies, let alone to suggest the relative weight to be attached to them. These will vary from case to case.

He added, at p. 409, that "there may be many other special factors to be taken into consideration in the particular circumstances of individual cases."

69 The decision in *Metropolitan Stores* , at p. 149, made clear that in all constitutional cases the public interest is a

  

'special factor' which must be considered in assessing where the balance of convenience lies and which must be "given the weight it should carry." This was the approach properly followed by Blair J. of the General Division of the Ontario Court in *Ainsley Financial Corp. v. Ontario Securities Commission* (1993), 14 O.R. (3d) 280 , at pp. 303-4:

> Interlocutory injunctions involving a challenge to the constitutional validity of legislation or to the authority of a law enforcement agency stand on a different footing than ordinary cases involving claims for such relief as between private litigants. The interests of the public, which the agency is created to protect, must be taken into account and weighed in the balance, along with the interests of the private litigants.

*1. The Public Interest*

70 Some general guidelines as to the methods to be used in assessing the balance of inconvenience were elaborated by Beetz J. in *Metropolitan Stores* . A few additional points may be made. It is the "polycentric" nature of the *Charter* which requires a consideration of the public interest in determining the balance of convenience: see Jamie Cassels, "An Inconvenient Balance: The Injunction as a Charter Remedy", in J. Berryman, ed., *Remedies: Issues and Perspectives* , 1991, 271, at pp. 301-5. However, the government does not have a monopoly on the public interest. As Cassels points out at p. 303:

> While it is of utmost importance to consider the public interest in the balance of convenience, the public interest in *Charter* litigation is not unequivocal or asymmetrical in the way suggested in *Metropolitan Stores* . The Attorney General is not the exclusive representative of a monolithic "public" in *Charter* disputes, nor does the applicant always represent only an individualized claim. Most often, the applicant can also claim to represent one vision of the "public interest". Similarly, the public interest may not always gravitate in favour of enforcement of existing legislation.

71 It is, we think, appropriate that it be open to both parties in an interlocutory *Charter* proceeding to rely upon considerations of the public interest. Each party is entitled to make the court aware of the damage it might suffer prior to a decision on the merits. In addition, either the applicant or the respondent may tip the scales of convenience in its favour by demonstrating to the court a compelling public interest in the granting or refusal of the relief sought. "Public interest" includes both the concerns of society generally and the particular interests of identifiable groups.

72 We would therefore reject an approach which excludes consideration of any harm not directly suffered by a party to the application. Such was the position taken by the trial judge in *Morgentaler v. Ackroyd* (1983), 150 D.L.R. (3d) 59 (Ont. H.C.) , per Linden J., at p. 66.

> The applicants rested their argument mainly on the irreparable loss to their potential women patients, who would be unable to secure abortions if the clinic is not allowed to perform them. Even if it were established that *these women* would suffer irreparable harm, such evidence would not indicate any irreparable harm to *these applicants* , which would warrant this court issuing an injunction at their behest. [Emphasis in original.]

73 When a private applicant alleges that the public interest is at risk that harm must be demonstrated. This is since private applicants are normally presumed to be pursuing their own interests rather than those of the public at large. In considering the balance of convenience and the public interest, it does not assist an applicant to claim that a given government authority does not represent the public interest. Rather, the applicant must convince the court of the public interest benefits which will flow from the granting of the relief sought.

74 Courts have addressed the issue of the harm to the public interest which can be relied upon by a public authority in different ways. On the one hand is the view expressed by the Federal Court of Appeal in *Attorney General of Canada v. Fishing Vessel Owners' Association of B.C.*, [1985] 1 F.C. 791 , which overturned the trial judge's issuance of an injunction restraining Fisheries Officers from implementing a fishing plan adopted under the *Fisheries Act* , R.S.C. 1970, c. F-14, for several reasons, including, at p. 795:

> (b) the Judge assumed that the grant of the injunction would not cause any damage to the appellants. This was wrong. When a public authority is prevented from exercising its statutory powers, it can be said, in a case like the present one,

  

> that the public interest, of which that authority is the guardian, suffers irreparable harm.

This dictum received the guarded approval of Beetz J. in *Metropolitan Stores* at p. 139. It was applied by the Trial Division of the Federal Court in *Esquimalt Anglers' Association v. Canada (Minister of Fisheries and Oceans)* (1988), 21 F.T.R. 304 .

75 A contrary view was expressed by McQuaid J.A. of the P.E.I. Court of Appeal in *Island Telephone Co., Re* (1987), 67 Nfld. & P.E.I.R. 158 , who, in granting a stay of an order of the Public Utilities Commission pending appeal, stated at p. 164:

> I can see no circumstances whatsoever under which the Commission itself could be inconvenienced by a stay pending appeal. As a regulatory body, it has no vested interest, as such, in the outcome of the appeal. In fact, it is not inconceivable that it should welcome any appeal which goes especially to its jurisdiction, for thereby it is provided with clear guidelines for the future, in situations where doubt may have therefore existed. The pub lic interest is equally well served, in the same sense, by any appeal....

76 In our view, the concept of inconvenience should be widely construed in *Charter* cases. In the case of a public authority, the onus of demonstrating irreparable harm to the public interest is less than that of a private applicant. This is partly a function of the nature of the public authority and partly a function of the action sought to be enjoined. The test will nearly always be satisfied simply upon proof that the authority is charged with the duty of promoting or protecting the public interest and upon some indication that the impugned legislation, regulation, or activity was undertaken pursuant to that responsibility. Once these minimal requirements have been met, the court should in most cases assume that irreparable harm to the public interest would result from the restraint of that action.

77 A court should not, as a general rule, attempt to ascertain whether actual harm would result from the restraint sought. To do so would in effect require judicial inquiry into whether the government is governing well, since it implies the possibility that the government action does not have the effect of promoting the public interest and that the restraint of the action would therefore not harm the public interest. The *Charter* does not give the courts a licence to evaluate the effectiveness of government action, but only to restrain it where it encroaches upon fundamental rights.

78 Consideration of the public interest may also be influenced by other factors. In *Metropolitan Stores* , it was observed that public interest considerations will weigh more heavily in a "suspension" case than in an "exemption" case. The reason for this is that the public interest is much less likely to be detrimentally affected when a discrete and limited number of applicants are exempted from the application of certain provisions of a law than when the application of certain provisions of a law is suspended entirely. See *Black v. Law Society of Alberta* (1983), 144 D.L.R. (3d) 439 ; *Vancouver General Hospital v. Stoffman* (1985), 23 D.L.R. (4th) 146 ; *Rio Hotel Ltd. v. Commission des licences et permis d'alcool*, [1986] 2 S.C.R. ix .

79 Similarly, even in suspension cases, a court may be able to provide some relief if it can sufficiently limit the scope of the applicant's request for relief so that the general public interest in the continued application of the law is not affected. Thus in *Ontario Jockey Club v. Smith* (1922), 22 O.W.N. 373 (H.C.) , the court restrained the enforcement of an impugned taxation statute against the applicant but ordered him to pay an amount equivalent to the tax into court pending the disposition of the main action.

*2. The Status Quo*

80 In the course of discussing the balance of convenience in *American Cyanamid* , Lord Diplock stated at p. 408 that when everything else is equal, "it is a counsel of prudence to ... preserve the status quo." This approach would seem to be of limited value in private law cases, and, although there may be exceptions, as a general rule it has no merit as such in the face of the alleged violation of fundamental rights. One of the functions of the *Charter* is to provide individuals with a tool to challenge the existing order of things or status quo. The issues have to be balanced in the manner described in these reasons.

***E. Summary***

81 It may be helpful at this stage to review the factors to be considered on an application for interlocutory relief in a

 

*Charter* case.

82 As indicated in *Metropolitan Stores* , the three-part *American Cyanamid* test should be applied to applications for interlocutory injunctions and as well for stays in both private law and *Charter* cases.

83 At the first stage, an applicant for interlocutory relief in a *Charter* case must demonstrate a serious question to be tried. Whether the test has been satisfied should be determined by a motions judge on the basis of common sense and an extremely limited review of the case on the merits. The fact that an appellate court has granted leave in the main action is, of course, a relevant and weighty consideration, as is any judgment on the merits which has been rendered, although neither is necessarily conclusive of the matter. A motions court should only go beyond a preliminary investigation of the merits when the result of the interlocutory motion will in effect amount to a final determination of the action, or when the constitutionality of a challenged statute can be determined as a pure question of law. Instances of this sort will be exceedingly rare. Unless the case on the merits is frivolous or vexatious, or the constitutionality of the statute is a pure question of law, a judge on a motion for relief must, as a general rule, consider the second and third stages of the *Metropolitan Stores* test.

84 At the second stage the applicant must convince the court that it will suffer irreparable harm if the relief is not granted. 'Irreparable' refers to the nature of the harm rather than its magnitude. In *Charter* cases, even quantifiable financial loss relied upon by an applicant may be considered irreparable harm so long as it is unclear that such loss could be recovered at the time of a decision on the merits.

85 The third branch of the test, requiring an assessment of the balance of inconvenience, will often determine the result in applications involving *Charter* rights. In addition to the damage each party alleges it will suffer, the interest of the public must be taken into account. The effect a decision on the application will have upon the public interest may be relied upon by either party. These public interest considerations will carry less weight in exemption cases than in suspension cases. When the nature and declared purpose of legislation is to promote the public interest, a motions court should not be concerned whether the legislation actually has such an effect. It must be assumed to do so. In order to overcome the assumed benefit to the public interest arising from the continued application of the legislation, the applicant who relies on the public interest must demonstrate that the suspension of the legislation would itself provide a public benefit.

86 We would add to this brief summary that, as a general rule, the same principles would apply when a government authority is the applicant in a motion for interlocutory relief. However, the issue of public interest, as an aspect of irreparable harm to the interests of the government, will be considered in the second stage. It will again be considered in the third stage when harm to the applicant is balanced with harm to the respondent including any harm to the public interest established by the latter.

## VII. Application of the Principles to these Cases

### *A. A Serious Question to be Tried*

87 The applicants contend that these cases raise several serious issues to be tried. Among these is the question of the application of the rational connection and the minimal impairment tests in order to justify the infringement upon freedom of expression occasioned by a blanket ban on tobacco advertising. On this issue, Chabot J. of the Quebec Superior Court and Brossard J.A. in dissent in the Court of Appeal held that the government had not satisfied these tests and that the ban could not be justified under s. 1 of the *Charter* . The majority of the Court of Appeal held that the ban was justified. The conflict in the reasons arises from different interpretations of the extent to which recent jurisprudence has relaxed the onus fixed upon the state in *R. v. Oakes*, [1986] 1 S.C.R. 103 , to justify its action in public welfare initiatives. This Court has granted leave to hear the appeals on the merits. When faced with separate motions for interlocutory relief pertaining to these cases, the Quebec Court of Appeal stated that "[w]hatever the outcome of these appeals, they clearly raise serious constitutional issues." This observation of the Quebec Court of Appeal and the decision to grant leaves to appeal clearly indicate that these cases raise serious questions of law.

### *B. Irreparable Harm*

88 The applicants allege that if they are not granted interlocutory relief they will be forced to spend very large sums of money immediately in order to comply with the regulations. In the event that their appeals are allowed by this Court, the applicants contend that they will not be able either to recover their costs from the government or to revert to their current packaging practices without again incurring the same expense.

89 Monetary loss of this nature will not usually amount to irreparable harm in private law cases. Where the government is the unsuccessful party in a constitutional claim, however, a plaintiff will face a much more difficult task in establishing constitutional liability and obtaining monetary redress. The expenditures which the new regulations require will therefore impose irreparable harm on the applicants if these motions are denied but the main actions are successful on appeal.

***C. Balance of Inconvenience***

90 Among the factors which must be considered in order to determine whether the granting or withholding of interlocutory relief would occasion greater inconvenience are the nature of the relief sought and of the harm which the parties contend they will suffer, the nature of the legislation which is under attack, and where the public interest lies.

91 The losses which the applicants would suffer should relief be denied are strictly financial in nature. The required expenditure is significant and would undoubtedly impose considerable economic hardship on the two companies. Nonetheless, as pointed out by the respondent, the applicants are large and very successful corporations, each with annual earnings well in excess of $50,000,000. They have a greater capacity to absorb any loss than would many smaller enterprises. Secondarily, assuming that the demand for cigarettes is not solely a function of price, the companies may also be able to pass on some of their losses to their customers in the form of price increases. Therefore, although the harm suffered may be irreparable, it will not affect the long-term viability of the applicants.

92 Second, the applicants are two companies who seek to be exempted from compliance with the latest regulations published under the *Tobacco Products Control Act* . On the face of the matter, this case appears to be an “exemption case” as that phrase was used by Beetz J. in *Metropolitan Stores* . However, since there are only three tobacco producing companies operating in Canada, the application really is in the nature of a “suspension case”. The applicants admitted in argument that they were in effect seeking to suspend the application of the new regulations to all tobacco producing companies in Canada for a period of one year following the judgment of this Court on the merits. The result of these motions will therefore affect the whole of the Canadian tobacco producing industry. Further, the impugned provisions are broad in nature. Thus it is appropriate to classify these applications as suspension cases and therefore ones in which “the public interest normally carries greater weight in favour of compliance with existing legislation” (p. 147).

93 The weight accorded to public interest concerns is partly a function of the nature of legislation generally, and partly a function of the purposes of the specific piece of legislation under attack. As Beetz J. explained, at p. 135, in *Metropolitan Stores* :

> Whether or not they are ultimately held to be constitutional, the laws which litigants seek to suspend or from which they seek to be exempted by way of interlocutory injunctive relief have been enacted by demo cratically-elected legislatures and are generally passed for the common good, for instance: ... *the protection of public health* .... It seems axiomatic that the granting of interlocutory injunctive relief in most suspension cases and, up to a point, as will be seen later, in quite a few exemption cases, is susceptible temporarily to frustrate the pursuit of the common good. [Emphasis added.]

94 The regulations under attack were adopted pursuant to s. 3 of the *Tobacco Products Control Act* which states:

> *3.* The purpose of this Act is to provide a legislative response to a national public health problem of substantial and pressing concern and, in particular,
>
> (*a* ) to protect the health of Canadians in the light of conclusive evidence implicating tobacco use in the incidence of numerous debilitating and fatal diseases;
>
> (*b* ) to protect young persons and others, to the extent that is reasonable in a free and democratic society, from

  

> inducements to use tobacco products and consequent dependence on them; and
>
> (*c* ) to enhance public awareness of the hazards of tobacco use by ensuring the effective communication of pertinent information to consumers of tobacco products.

95 The Regulatory Impact Analysis Statement, in the *Canada Gazette* , Part II, Vol. 127, No. 16, p. 3284, at p. 3285, which accompanied the regulations stated:

> The increased number and revised format of the health messages reflect the strong consensus of the public health community that the serious health hazards of using these products be more fully and effectively communicated to consumers. Support for these changes has been manifested by hundreds of letters and a number of submissions by public health groups highly critical of the initial regulatory requirements under this legislation as well as a number of Departmental studies indicating their need.

96 These are clear indications that the government passed the regulations with the intention of protecting public health and thereby furthering the public good. Further, both parties agree that past studies have shown that health warnings on tobacco product packages do have some effects in terms of increasing public awareness of the dangers of smoking and in reducing the overall incidence of smoking in our society. The applicants, however, argued strenuously that the government has not shown and cannot show that the specific requirements imposed by the impugned regulations have any positive public benefits. We do not think that such an argument assists the applicants at this interlocutory stage.

97 When the government declares that it is passing legislation in order to protect and promote public health and it is shown that the restraints which it seeks to place upon an industry are of the same nature as those which in the past have had positive public benefits, it is not for a court on an interlocutory motion to assess the actual benefits which will result from the specific terms of the legislation. That is particularly so in this case, where this very matter is one of the main issues to be resolved in the appeal. Rather, it is for the applicants to offset these public interest considerations by demonstrating a more compelling public interest in suspending the application of the legislation.

98 The applicants in these cases made no attempt to argue any public interest in the continued application of current packaging requirements rather than the new requirements. The only possible public interest is that of smokers' not having the price of a package of cigarettes increase. Such an increase is not likely to be excessive and is purely economic in nature. Therefore, any public interest in maintaining the current price of tobacco products cannot carry much weight. This is particularly so when it is balanced against the undeniable importance of the public interest in health and in the pre vention of the widespread and serious medical problems directly attributable to smoking.

99 The balance of inconvenience weighs strongly in favour of the respondent and is not offset by the irreparable harm that the applicants may suffer if relief is denied. The public interest in health is of such compelling importance that the applications for a stay must be dismissed with costs to the successful party on the appeal.

*Applications dismissed.*

Solicitors of record:
Solicitors for the applicant RJR — MacDonald Inc.: *Mackenzie, Gervais* , Montreal.
Solicitors for the applicant Imperial Tobacco Inc.: *Ogilvy, Renault* , Montreal.
Solicitors for the respondent: *Côté & Ouellet* , Montreal.
Solicitors for the interveners on the application for interlocutory relief the Heart and Stroke Foundation of Canada, the Canadian Cancer Society, the Canadian Council on Smoking and Health, and Physicians for a Smoke-Free Canada: *McCarthy, Tétrault* , Toronto.

1994 CarswellQue 120, 1994 CarswellQue 120F, [1994] 1 S.C.R. 311...

EB-2019-0242
Brief of Authorities to
AMPCO Submissions for Motion for Stay

**TAB C**

*134 FERC, 18 CFR part 35, Docket No. RM10-17-000, Order No. 75, Demand Response Compensation in Organized Wholesale Energy Markets, March 15, 2011*

134 FERC ¶ 61,187

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

18 CFR Part 35

[Docket No. RM10-17-000; Order No. 745]

# Demand Response Compensation in Organized Wholesale Energy Markets

(Issued March 15, 2011)

AGENCY: Federal Energy Regulatory Commission.

ACTION: Final Rule.

SUMMARY: In this Final Rule, the Federal Energy Regulatory Commission (Commission) amends its regulations under the Federal Power Act to ensure that when a demand response resource participating in an organized wholesale energy market administered by a Regional Transmission Organization (RTO) or Independent System Operator (ISO) has the capability to balance supply and demand as an alternative to a generation resource and when dispatch of that demand response resource is cost-effective as determined by the net benefits test described in this rule, that demand response resource must be compensated for the service it provides to the energy market at the market price for energy, referred to as the locational marginal price (LMP). This approach for compensating demand response resources helps to ensure the competitiveness of organized wholesale energy markets and remove barriers to the participation of demand response resources, thus ensuring just and reasonable wholesale rates.

EFFECTIVE DATE: This Final Rule will become effective on **[**INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER**]**. Dates for compliance and other required filings are provided in the Final Rule.

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SUPPLEMENTARY INFORMATION:

134 FERC ¶ 61,187
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Demand Response Compensation in Organized Wholesale Energy Markets — Docket No. RM10-17-000

ORDER NO. 745

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(Issued March 15, 2011)

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
John R. Norris, and Cheryl A. LaFleur.

Demand Response Compensation in Organized Wholesale Energy Markets — Docket No. RM10-17-000

FINAL RULE

ORDER NO. 745

(Issued March 15, 2011)

## I. Introduction

1. This Final Rule addresses compensation for demand response in Regional Transmission Organization (RTO) and Independent System Operator (ISO) organized wholesale energy markets, i.e., the day-ahead and real-time energy markets. As the Commission has previously recognized, a market functions effectively only when both supply and demand can meaningfully participate. The Commission, in the Notice of Proposed Rulemaking (NOPR) issued in this proceeding on March 18, 2010, proposed a remedy to concerns that current compensation levels inhibited meaningful demand-side participation.[1] After nearly 3,800 pages of comments, a subsequent technical conference, and the opportunity for additional comment, we now take final action.

[1] Demand Response Compensation in Organized Wholesale Energy Markets, Notice of Proposed Rulemaking, 75 FR 15362 (Mar. 29, 2010), FERC Stats. & Regs. ¶ 32,656 (2010) (NOPR).

2. We conclude that when a demand response[2] resource[3] participating in an organized wholesale energy market[4] administered by an RTO or ISO has the capability to balance supply and demand as an alternative to a generation resource and when dispatch of that demand response resource is cost-effective as determined by the net benefits test described herein, that demand response resource must be compensated for the service it provides to the energy market at the market price for energy, referred to as the locational marginal price (LMP).[5] The Commission finds that this approach to compensation for

[2] Demand response means a reduction in the consumption of electric energy by customers from their expected consumption in response to an increase in the price of electric energy or to incentive payments designed to induce lower consumption of electric energy. 18 CFR 35.28(b)(4) (2010).

[3] Demand response resource means a resource capable of providing demand response. 18 CFR 35.28(b)(5).

[4]The requirements of this final rule apply only to a demand response resource participating in a day-ahead or real-time energy market administered by an RTO or ISO. Thus, this Final Rule does not apply to compensation for demand response under programs that RTOs and ISOs administer for reliability or emergency conditions, such as, for instance, Midwest ISO's Emergency Demand Response, NYISO's Emergency Demand Response Program, and PJM's Emergency Load Response Program. This Final Rule also does not apply to compensation in ancillary services markets, which the Commission has addressed elsewhere. See, e.g., Wholesale Competition in Regions with Organized Electric Markets, Order No. 719, 73 FR 64100 (Oct. 28, 2008), FERC Stats. & Regs. ¶ 31,281 (2008) (Order No. 719).

[5] LMP refers to the price calculated by the ISO or RTO at particular locations or electrical nodes or zones within the ISO or RTO footprint and is used as the market price to compensate generators. There are variations in the way that RTOs and ISOs calculate LMP; however, each method establishes the marginal value of resources in that market. Nothing in this Final Rule is intended to change RTO and ISO methods for calculating LMP.

demand response resources is necessary to ensure that rates are just and reasonable in the organized wholesale energy markets. Consistent with this finding, this Final Rule adds section 35.28(g)(1)(v) to the Commission's regulations to establish a specific compensation approach for demand response resources participating in the organized wholesale energy markets administered by RTOs and ISOs. The Commission is not requiring the use of this compensation approach when demand response resources do not satisfy the capability and cost-effectiveness conditions noted above.[6]

3. This cost-effectiveness condition, as determined by the net benefits test described herein, recognizes that, depending on the change in LMP relative to the size of the energy market, dispatching demand response resources may result in an increased cost per unit ($/MWh) to the remaining wholesale load associated with the decreased amount of load paying the bill. This is the case because customers are billed for energy based on the units, MWh, of electricity consumed. We refer to this potential result as the billing unit effect of dispatching demand response. By contrast, dispatching generation resources does not produce this billing unit effect because it does not result in a decrease of load. To address this billing unit effect, the Commission in this Final Rule requires the use of the net benefits test described herein to ensure that the overall benefit of the reduced

[6] The Commission's findings in this Final Rule do not preclude the Commission from determining that other approaches to compensation would be acceptable when these conditions are not met.

LMP that results from dispatching demand response resources exceeds the cost of dispatching and paying LMP to those resources. When the net benefits test described herein is satisfied and the demand response resource clears in the RTO's or ISO's economic dispatch, the demand response resource is a cost-effective alternative to generation resources for balancing supply and demand.

4. To implement the net benefits test described herein, we direct each RTO and ISO to develop a mechanism as an approximation to determine a price level at which the dispatch of demand response resources will be cost-effective. The RTO or ISO should determine, based on historical data as a starting point and updated for changes in relevant supply conditions such as changes in fuel prices and generator unit availability, the monthly threshold price corresponding to the point along the supply stack beyond which the overall benefit from the reduced LMP resulting from dispatching demand response resources exceeds the cost of dispatching and paying LMP to those resources. This price level is to be updated monthly, by each ISO or RTO, as the historic data and relevant supply conditions change.[7]

[7] In its compliance filing an RTO or ISO may attempt to show, in whole or in part, how its proposed or existing practices are consistent with or superior to the requirements of this Final Rule.

5. This Final Rule also sets forth a method for allocating the costs of demand response payments among all customers who benefit from the lower LMP resulting from the demand response.

6. The tariff changes needed to implement the compensation approach required in this Final Rule, including the net benefits test, measurement and verification explanation and proposed changes, and the cost allocation mechanism must be made on or before July 22, 2011. All tariff changes directed herein should be submitted as compliance filings pursuant to this Final Rule, not pursuant to section 205 of the Federal Power Act (FPA).[8] Accordingly, each RTO's or ISO's compliance filing to this Final Rule will become effective prospectively from the date of the Commission order addressing that filing, and not within 60 days of submission.

7. In addition, we believe that integrating a determination of the cost-effectiveness of demand response resources into the dispatch of the ISOs and RTOs may be more precise than the monthly price threshold and, therefore, provide the greatest opportunity for load to benefit from participation of demand response in the organized wholesale energy market administered by an RTO or ISO. However, we acknowledge the position of several of the RTOs and ISOs that modification of their dispatch algorithms to incorporate the costs related to demand response may be difficult in the near term. In

[8] 16 U.S.C. 824d (2006).

light of those concerns, we require each RTO and ISO to undertake a study examining the requirements for and impacts of implementing a dynamic approach which incorporates the billing unit effect in the dispatch algorithm to determine when paying demand response resources the LMP results in net benefits to customers in both the day-ahead and real-time energy markets. The Commission directs each RTO and ISO to file the results of this study with the Commission on or before September 21, 2012.[9]

## II. Background

8. Effective wholesale competition protects customers by, among other things, providing more supply options, encouraging new entry and innovation, and spurring deployment of new technologies.[10] Improving the competitiveness of organized wholesale energy markets is therefore integral to the Commission fulfilling its statutory mandate under the FPA to ensure supplies of electric energy at just, reasonable, and not unduly discriminatory or preferential rates.[11]

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[9] We note that this report is for informational purposes only and will neither be noticed nor require Commission action.

[10] See, e.g., Wholesale Competition in Regions with Organized Electric Markets, Order No. 719, 73 FR 64100 (Oct. 28, 2008), FERC Stats. & Regs. ¶ 31,281, at P 1 (2008) (Order No. 719); see also Regional Transmission Organizations, Order No. 2000, FERC Stats. & Regs. ¶ 31,089, at P 1 (1999), order on reh'g, Order No. 2000-A, FERC Stats. & Regs. ¶ 31,092 (2000), aff'd sub nom. Pub. Util. Dist. No. 1 of Snohomish County, Washington v. FERC, 272 F.3d 607, 348 U.S. App. D.C. 205 (D.C. Cir. 2001).

[11] 16 U.S.C. 824d (2006); Order No. 719, FERC Stats. & Regs. ¶ 31,281 at P 1.

9. As the Commission recognized in Order No. 719, active participation by customers in the form of demand response in organized wholesale energy markets helps to increase competition in those markets.[12] Demand response, whereby customers reduce electricity consumption from normal usage levels in response to price signals, can generally occur in two ways: (1) customers reduce demand by responding to retail rates that are based on wholesale prices (sometimes called "price-responsive demand"); and (2) customers provide demand response that acts as a resource in organized wholesale energy markets to balance supply and demand. While a number of states and utilities are pursuing retail-level price-responsive demand initiatives based on dynamic and time-differentiated retail prices and utility investments in demand response enabling technologies, these are state efforts, and, thus, are not the subject of this proceeding. Our focus here is on customers or aggregators of retail customers providing, through bids or self-schedules, demand response that acts as a resource in organized wholesale energy markets.

10. As the Commission stated in Order No. 719,[13] and emphasized in the NOPR,[14] there are several ways in which demand response in organized wholesale energy markets

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[12] See Order No. 719, FERC Stats. & Regs. ¶ 31,281 at P 48.

[13] Wholesale Competition in Regions with Organized Electric Markets, Order No. 719-A, FERC Stats. & Regs. ¶ 31,292, at P 48 (2009).

[14] NOPR, FERC Stats. & Regs. ¶ 32,656 at P 4.

can help improve the functioning and competitiveness of those markets. First, when bid directly into the wholesale market, demand response can facilitate RTOs and ISOs in balancing supply and demand, and thereby, help produce just and reasonable energy prices.[15] This is because customers who choose to respond will signal to the RTO or ISO and energy market their willingness to reduce demand on the grid which may result in reduced dispatch of higher-priced resources to satisfy load.[16] Second, demand response can mitigate generator market power.[17] This is because the more demand response that sees and responds to higher market prices, the greater the competition, and the more downward pressure it places on generator bidding strategies by increasing the risk to a supplier that it will not be dispatched if it bids a price that is too high.[18] Third, demand

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[15] For example, a study conducted by PJM, which simulated the effect of demand response on prices, demonstrated that a modest three percent load reduction in the 100 highest peak hours corresponds to a price decline of six to 12 percent. ISO-RTO Council Report, Harnessing the Power of Demand How RTOs and ISOs Are Integrating Demand Response into Wholesale Electricity Markets, found at http://www.isorto.org/atf/cf/%7B5B4E85C6-7EAC-40A0-8DC3-003829518EBD%7D/IRC_DR_Report_101607.pdf.

[16] Id. ("Demand response tends to flatten an area's load profile, which in turn may reduce the need to construct and use more costly resources during periods of high demand; the overall effect is to lower the average cost of producing energy.").

[17] See Comments of NYISO's Independent Market Monitor filed in Docket No. ER09-1142-000, May 15, 2009 (Demand response "contributes to reliability in the short-term, resource adequacy in the long-term, reduces price volatility and other market costs, and mitigates supplier market power.").

[18] Id.

response has the potential to support system reliability and address resource adequacy[19] and resource management challenges surrounding the unexpected loss of generation. This is because demand response resources can provide quick balancing of the electricity grid.[20]

11. Congress has recognized the importance of demand response by enacting national policy requiring its facilitation.[21] Consistent with that policy, the Commission has undertaken several reforms to support competitive wholesale energy markets by removing barriers to participation of demand response resources. For example, in Order No. 890, the Commission modified the pro forma Open Access Transmission Tariff to

[19] See ISO-RTO Council Report, Harnessing the Power of Demand How RTOs and ISOs Are Integrating Demand Response into Wholesale Electricity Markets at 4, found at http://www.isorto.org/atf/cf/%7B5B4E85C6-7EAC-40A0-8DC3-003829518EBD%7D/IRC_DR_Report_101607.pdf ("Demand response contributes to maintaining system reliability. Lower electric load when supply is especially tight reduces the likelihood of load shedding. Improvements in reliability mean that many circumstances that otherwise result in forced outages and rolling blackouts are averted, resulting in substantial financial savings . . . .").

[20] For instance, in ERCOT, on February 26, 2008, through a combination of a sudden loss of thermal generation, drop in power supplied by wind generators, and a quicker-than-expected ramping up of demand, ERCOT found itself short of reserves. The system operator called on all demand response resources, and 1200 MW of Load acting as Resource (LaaRs) responded quickly, bringing ERCOT back into balance. OAK RIDGE NAT'L LAB., NAT'L RENEWABLE ENERGY LAB., TECH. REP. NREL/TP-500-43373, ERCOT EVENT ON FEB. 26, 2008: LESSONS LEARNED (JUL. 2008).

[21] See Energy Policy Act of 2005, Pub. L. No. 109-58, § 1252(f), 119 Stat. 594, 965 (2005) ("It is the policy of the United States that . . . unnecessary barriers to demand response participation in energy, capacity, and ancillary service markets shall be eliminated.").

allow non-generation resources, including demand response resources, to be used in the provision of certain ancillary services where appropriate on a comparable basis to service provided by generation resources.[22] Order No. 890-A further required transmission providers to develop transmission planning processes that treat all resources, including demand response, on a comparable basis.[23]

12. In Order No. 719, the Commission required RTOs and ISOs to, among other things, accept bids from demand response resources in their markets for certain ancillary services on a basis comparable to other resources.[24] The Commission also required each RTO and ISO "to reform or demonstrate the adequacy of its existing market rules to ensure that the market price for energy reflects the value of energy during an operating reserve shortage,"[25] for purposes of encouraging existing generation and demand resources to continue to be relied upon during an operating reserve shortage, and encouraging entry of new generation and demand resources.[26]

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[22] Preventing Undue Discrimination and Preference in Transmission Service, Order No. 890, FERC Stats. & Regs. ¶ 31,241, at P 887-88 (2007), order on reh'g, Order No. 890-A, FERC Stats. & Regs. ¶ 31,261 (2007), order on reh'g and clarification, Order No. 890-B, 123 FERC ¶ 61,299 (2008), order on reh'g, Order No. 890-C, 126 FERC ¶ 61,228 (2009), order on clarification, Order No. 890-D, 129 FERC ¶ 61,126 (2009).

[23] Order No. 890-A, FERC Stats. & Regs. ¶ 31,261 at P 216.

[24] Order No. 719, FERC Stats. & Regs. ¶ 31,281 at P 47-49.

[25] Order No. 719, FERC Stats. & Regs. ¶ 31,281 at P 194.

[26] Order No. 719, FERC Stats. & Regs. ¶ 31,281 at P 247.

13. Additionally, in recent years several RTOs and ISOs have instituted various types of demand response programs. While some of these programs are administered for reliability and emergency conditions, other programs allow wholesale customers, qualifying large retail customers, and aggregators of retail customers to participate directly in the day-ahead and real-time energy markets, certain ancillary service markets and capacity markets.[27]

14. To date, the Commission has allowed each RTO and ISO to develop its own compensation methodologies for demand response resources participating in its day-ahead and real-time energy markets. As a result, the levels of compensation for demand response vary significantly among RTOs and ISOs.[28] For example, PJM Interconnection, L.L.C. (PJM) pays the LMP minus the generation and transmission portions of the retail

[27] Other demand response programs allow demand response to be used as a capacity resource and as a resource during system emergencies or permit the use of demand response for synchronized reserves and regulation service. See, e.g., PJM Interconnection, L.L.C., 117 FERC ¶ 61,331 (2006); Devon Power LLC, 115 FERC ¶ 61,340, order on reh'g, 117 FERC ¶ 61,133 (2006), appeal pending sub nom. Maine Pub. Utils. Comm'n v. FERC, No. 06-1403 (D.C. Cir. 2007); New York Indep. Sys. Operator, Inc., 95 FERC ¶ 61,136 (2001); NSTAR Services Co. v. New England Power Pool, 95 FERC ¶ 61,250 (2001); New England Power Pool and ISO New England, Inc., 100 FERC ¶ 61,287, order on reh'g, 101 FERC ¶ 61,344 (2002), order on reh'g, 103 FERC ¶ 61,304, order on reh'g, 105 FERC ¶ 61,211 (2003); PJM Interconnection, L.L.C., 99 FERC ¶ 61,227 (2002); California Independent System Operator Corp., 132 FERC ¶ 61,045 (2010).

[28] See New England, Inc., Docket No. ER09-1051-000; ISO New England, Inc., Docket No. ER08-830-000; Midwest Indep. Transmission Sys. Operator, Inc., Docket No. ER09-1049-000.

rate.[29] ISO New England Inc. (ISO-NE) and New York Independent System Operator, Inc. (NYISO) pay LMP when prices exceed a threshold level, with the levels differing between the RTOs.[30] The Midwest Independent Transmission System Operator, Inc.'s (Midwest ISO) demand response programs[31] pay LMP for demand response resources in the day-ahead and real-time energy markets.[32] The California Independent System Operator Corporation (CAISO) pays LMP at pricing nodes, or sub-load aggregation points (Sub-LAP) in its Proxy Demand Resource program that allows qualifying

[29] See sections 3.3A.4 and 3.3A.5 (Market Settlements in the Real-Time and Day-Ahead Energy Markets) of the Appendix to Attachment K of the PJM Tariff.

[30] For example, under ISO-NE's Real-Time Price Response Program, the minimum bid is $100/MWh and a demand response resource is paid the higher of LMP or $100/MWh. For the Day-Ahead Load Response Program, the minimum offer level is calculated on a monthly basis and is the Forward Reserve Fuel Index ($/MMBtu) multiplied by an effective heat rate of 11.37 MMBtu/MWh. The maximum offer level is $1,000/MWh. See sections III.E.2.1 and III.E.3.2 of Appendix E of the ISO New England Transmission, Markets and Services Tariff. NYISO implements a day-ahead demand response program by which resources bid into the market at a minimum of $75/MWh and can get paid the LMP. See section 4.2.2.9 ("Day-Ahead Bids from Demand Reduction Providers to Supply Energy from Demand Reductions") of NYISO's Market Services Tariff.

[31] Midwest ISO FERC Electric Tariff characterizes Demand Response Resources (DRR) as either DRR-Type I or DRR-Type II. DRR-Type I are capable of supplying a specific quantity of energy or contingency reserve through physical load interruption. DRR-Type II are capable of supplying energy and/or operating reserves over a dispatchable range. See sections 39.2.5A and 40.2.5 of the Tariff.

[32] See Charges and Payments for Purchases and Sales for Demand Response Resources. Midwest ISO FERC Electric Tariff, section 39.3.2C.

resources to provide day-ahead and real-time energy.[33] CAISO also provides for demand response resources to participate in its Participating Load program, which enables certain resources to provide curtailable demand in the CAISO market. CAISO pays nodal real-time LMP for its Participating Load program. The Southwest Power Pool, Inc. (SPP) has filed revisions to its tariff to facilitate demand response in the Energy Imbalance Service Market.[34]

## III. Procedural History

15. As noted above, the Commission issued the NOPR in this proceeding on March 18, 2010.[35] The NOPR proposed to require RTOs and ISOs to pay the LMP in all hours for demand reductions made in response to price signals. The Commission sought

[33] See section 11.2.1.1 IFM Payments for Supply of Energy, CAISO FERC Electric Tariff. CAISO notes that for a Proxy Demand Resource that is made up of aggregated loads, the Resource is paid the weighted average of the LMPs of each pricing node where the underlying aggregate loads reside. See CAISO, 132 FERC ¶ 61,045, at P 26 n.14 (2010).

[34] The Commission has directed SPP to report on ways it can incorporate demand response into its imbalance market. Southwest Power Pool, Inc., 128 FERC ¶ 61,085 (2009). As of September 1, 2010, SPP has submitted seven informational status reports regarding its efforts to address issues related to demand response resources. In orders addressing SPP's compliance with Order No. 719, the Commission also directed SPP to make another compliance filing addressing demand response participation in its organized markets. Southwest Power Pool, Inc., 129 FERC ¶ 61,163, at P 51 (2009). On May 19, 2010, SPP submitted revisions to its Open Access Transmission Tariff in Docket Nos. ER09-1050-004 and ER09-748-002 to comply with the Commission's requirements established in Order Nos. 719 and 719-A. These filings are pending before the Commission.

[35] NOPR, FERC Stats. & Regs. ¶ 32,656.

comments on the compensation proposal and, in particular, on the comparability of generation and demand response resources; alternative approaches to compensating demand response in organized wholesale energy markets; whether payment of LMP should apply in all hours, and, if not, any criteria that should be used for establishing hours when LMP should apply; and whether to allow for regional variations concerning approaches to demand response compensation.[36]

16. After receiving the first round of comments, the Commission issued a Supplemental Notice of Proposed Rulemaking and Notice of Technical Conference (Supplemental NOPR) in this proceeding on August 2, 2010.[37] The Supplemental NOPR sought additional comment on: whether the Commission should adopt a net benefits test for determining when to compensate demand response providers, and, if so, what, if any, requirements should apply to the methods for determining net benefits; and what, if any, requirements should apply to how the costs of demand response are allocated. The Commission further directed Staff to hold a technical conference focused on these two issues, which occurred on September 13, 2010.[38]

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[36] See Appendix for a list of commenters.

[37] Supplemental Notice of Proposed Rulemaking and Notice of Technical Conference, 75 FR 47499 (Aug. 6, 2010), 132 FERC ¶ 61,094 (2010) (Supplemental NOPR).

[38] See Notice of Technical Conference (Aug. 27, 2010).

## IV. Discussion

17. Based upon the record in this proceeding, the Commission herein requires greater uniformity in compensating demand response resources participating in organized wholesale energy markets. This Final Rule also addresses the allocation of costs resulting from the commitment of demand response, directing that such costs be allocated among those customers who benefit from the lower LMP resulting from the demand response.

### A. Compensation Level

#### 1. NOPR Proposal

18. The NOPR proposed to require RTOs and ISOs to pay the LMP in all hours for demand reductions made in response to price signals. The NOPR sought to provide comparable compensation to generation and demand response providers, based on the premise that both resources provide a comparable service to RTOs and ISOs for purposes of balancing supply and demand and maintaining a reliable electricity grid.[39] Also as stated in the NOPR, the proposed compensation level was designed to allow more demand response resources to cover their investment costs in demand response-related technology (such as advanced metering) and thereby facilitate their ability to participate in organized wholesale energy markets.[40] The Commission sought comments on the

[39] NOPR, FERC Stats. & Regs. ¶ 32,656 at P 15.

[40] Id. at P 16.

compensation proposal and, in particular, on the comparability of generation and demand response resources; alternative approaches to compensating demand response in organized wholesale energy markets; whether payment of LMP should apply in all hours, and, if not, any criteria that should be used for establishing hours when LMP should apply; and whether to allow for regional variations concerning approaches to demand response compensation.

19. In the Supplemental NOPR, the Commission sought additional comments and directed staff to hold a technical conference regarding various net benefits tests. In particular, the Commission sought comment on: whether the Commission should adopt a net benefits test applicable in all or only some hours and what the criteria of any such test would be; how to define net benefits; what costs demand response providers and load serving entities incur and whether they should be included in a net benefits test; whether any net benefits methodology adopted should be the same for all RTOs and ISOs; proposed methodologies for implementing a net benefits test and the advantages and limitations of any proposed methodologies.[41] The September 13, 2010 Technical Conference included an eleven-member panel discussion of net benefits tests representing

[41] Supplemental NOPR, 132 FERC ¶ 61,094 at P 8-9.

a wide range of interests and viewpoints.[42] The Commission subsequently received additional written comments addressing these issues.

### 2. Comments

#### a) Capability of Demand Response and Generation Resources to Balance Energy Markets

20. Various commenters address the comparability of demand response and generation resources for purposes of compensation in the organized wholesale energy markets. To begin, numerous commenters address the physical or functional comparability of demand response and generation, agreeing that an increment of generation is comparable to a decrement of load for purposes of balancing supply and demand in the day-ahead and real-time energy markets.[43] Equating generation and demand response resources, Dr. Alfred E. Kahn states:

> [Demand response] is in all essential respects economically equivalent to supply response . . . [so] economic efficiency requires . . . that it should be rewarded with the same LMP that clears the market. Since [demand response] is actually—and not merely metaphorically—equivalent to supply response, economic efficiency requires that it be regarded and rewarded, equivalently, as a resource proffered to system operators, and be treated equivalently to generation in competitive power markets. That is,

[42] See Sept. 13, 2010 Tr.

[43] DR Supporters Aug. 30, 2010 Comments (Kahn Affidavit at 2); Verso May 13, 2010 Comments at 3-4; Occidental May 13, 2010 Comments at 11; Viridity June 18, 2010 Comments at 5.

> all resources—energy saved equivalently to energy supplied— . . . should receive the same market-clearing LMP in remuneration.[44]

Indeed, some commenters believe that, from a physical standpoint, demand response can provide superior services to generation, such as providing a quick response in meeting system requirements and service without having to construct major new facilities.[45] Occidental asserts that the fungibility of demand response and generation output creates greater operational flexibility that, in turn, offers RTOs and ISOs multiple options to solve system issues both in energy and ancillary service markets, and that the fungible nature of demand response and generation supports comparable compensation for each as proposed in the NOPR.[46]

21. Viridity states that attempts to distinguish the physical characteristics of generation and demand response ignore bid-based security-constrained economic dispatch as the foundation for LMP and are based on the assumption that the value of load management on the grid is limited to periods when the system is stressed, i.e., traditional "super peak shaving." Viridity states that, while these arguments might have been valid 15 years ago, today competitive markets can offer proactively-managed load control and comparable and non-discriminatory treatment of load-based energy resources.

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[44] DR Supporters August 30, 2010 Reply Comments (Kahn Affidavit at 2 (footnote omitted)).

[45] Verso May 13, 2010 Comments at 3-4; Alcoa May 13, 2010 Comments at 9.

[46] Occidental May 13, 2010 Comments at 11.

Therefore, Viridity asserts that all resources should be paid LMP if the grid operator accepts their bid to achieve grid balance.[47]

22. At the same time, other commenters argue that generation and demand response are not physically equivalent, pointing out that demand response reduces consumption, whereas generators serve consumption.[48] They argue that a MW reduction in demand does not turn on the lights.[49] EPSA adds that a load reduction does not provide electrons to any other load and, instead, allows the marginal electron to serve a different customer.[50] Some commenters assert that a power system can function solely and reliably on generating plants and without any reliance on demand response, while the system cannot rely exclusively on demand response because demand response by itself cannot keep the lights on. Ultimately, some commenters point out, megawatts produced by generators need to be placed on the system in order for power to flow.[51] Battelle additionally argues that a reduction in consumption is not exactly the same as an increase

[47] Viridity June 18, 2010 Comments at 5.

[48] ISO-NE May 13, 2010 Comments at 3.

[49] See, e.g., APPA May 13, 2010 Comments at 12; Capital Power May 13, 2010 Comments at 2.

[50] EPSA May 13, 2010 Comments at 72.

[51] See, e.g., PSEG May 13, 2010 Comments at 8.

in production, because elastic demand often comes with attendant future consequences, such as rebound, by virtue of substitution in time.[52]

23. Some commenters who argue that the physical characteristics of demand response are not comparable to generation frame their arguments in terms of the ability of the system operator to call on demand response and generation resources to provide balancing energy. They argue that generation resources provide superior service to demand response providers, positing that demand response is not intended for long periods of balancing needs,[53] and that, moreover, contracts with demand response providers limit the number of hours and times a customer may be called upon to curtail. For example, ODEC asserts that the degree of physical comparability depends on the extent to which demand response resources can be dispatched similar to a generator.[54] Calpine adds that traditional generators provide system support features that demand response cannot, such as ancillary services including governor response or reactive power voltage support, which are necessary for reliable operation of the electric system.[55]

24. Numerous commenters also address the comparability of demand response and generation in economic terms. For example, EEI states that, in finance terms, the demand

[52] Battelle May 13, 2010 Comments at 3.

[53] AEP May 13, 2010 Comments at 7-8.

[54] ODEC May 13, 2010 Comments at 12.

[55] Calpine May 13, 2010 Comments at 4-5.

response product is, unlike generation, essentially an unexercised call option on spot market energy, and the value of that option is well-established in finance theory as the value of the resource (LMP) minus the "strike price," which EEI contends in this case is the retail tariff rate.[56] EEI and like-minded commenters support, therefore, alternative compensation for demand response to equal LMP minus the generation (or G) component of the retail rate.[57] They posit that payment of LMP without an offset for some portion of the retail rate does not send the proper economic signal to providers of demand response, because it fails to take into account the retail rate savings associated with demand response, and thereby overcompensates the demand response provider. As described by Dr. William W. Hogan on behalf of EPSA, this is sometimes called a double-payment for demand reductions, because demand response providers would "receive" both the cost

[56] EEI May 13, 2010 Comments at 4-5. See also Robert L. Borlick May 13, 2010 Comments at 4. Mr. Borlick argues that the correct price is LMP minus the Marginal Foregone Retail Rate (MFRR), describing the economically efficient price that should be paid to a demand response provider as "its offer price minus the price in its retail tariff at which it would have purchased the curtailed energy." Mr. Borlick asserts that this amount accurately represents the forgone opportunity costs that result when a demand response provider reduces its load. Id.

[57] See May 13, 2010 Comments of: APPPA; AEP; The Brattle Group; Calpine; ConEd; Consumers Energy; CPG; Detroit Edison; Direct Energy; Dominion; Duke Energy; Edison Mission; EEI; EPSA; Exelon; FTC; GDF; NYISO on behalf of the ISO RTO Council; ICC; IPPNY; Indicated New York TOs; IPA; ISO-NE; Midwest TDUs; Mirant; Midwest ISO TOs; NEPGA; NYISO; ODEC; OMS; PJM; PJM IMM; P3; Potomac Economics; PG&E; Ohio Commission; Robert L. Borlick; Roy Shanker; and RRI Energy.

savings from not consuming an increment of electricity at a particular price, plus an LMP payment for not consuming that same increment of electricity.[58] Viewing LMP as a double-payment, these commenters argue that paying LMP will result in more demand response than is economically efficient.[59] For example, Dr. Hogan states that paying LMP might motivate a company to shut down even though the benefits of consuming electricity outweigh the cost at LMP.[60] Indeed, P3 argues that compensation in excess of LMP-G is unjust and unreasonable, because such a payment level imposes costs on customers that are not commensurate with benefits received.[61]

25. ISO-NE argues that paying full LMP to demand response providers without taking into account the bill savings produced by demand response provides a significant financial incentive to dispatch demand response with marginal costs exceeding LMPs. By dispatching higher-cost demand response, ISO-NE asserts, lower-cost generation

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[58] See Attachment to Answer of EPSA, Providing Incentives for Efficient Demand Response, Dr. William W. Hogan, Oct. 29, 2009, submitted in Docket No. EL09-68-000.

[59] EPSA May 13, 2010 Comments at 23. See also May 13, 2010 Comments of APPA at 13; FTC at 9; Midwest TDUs at 14; Mirant at 2; New York Commission at 5; PJM at 6; PSEG at 5; and Potomac Economics at 6-8.

[60] Attachment to Answer of EPSA, Providing Incentives for Efficient Demand Response, Dr. William W. Hogan, Oct. 29, 2009, submitted in Docket No. EL09-68-000. In Dr. Hogan's view, supply should produce when the price of electricity exceeds its cost of production and demand should decline to consume when the costs in terms of convenience of delaying use are less than the price of electricity.

[61] P3 June 14, 2010 Comments at 2, 7-8.

resources are displaced.[62] At the same time, ISO-NE argues, generation is not dispatched and paid for only when the generation reduces LMP—generation is dispatched and paid for when it is cost-effective.[63]

26. Dr. Hogan further disputes arguments equating a MW of energy supplied to a MW of energy saved on economic grounds. Dr. Hogan draws a distinction between reselling something that one has purchased, and selling something that one would have purchased without actually purchasing it. Dr. Hogan argues that from the perspective of economic efficiency and welfare maximization, the aggregate effect of demand response is a wash producing no economic net benefit. Dr. Hogan asserts that Commission policy citing the benefits of price reduction in support of demand response compensation would amount to no less than an application of regulatory authority to enforce a buyers' cartel. He states that the Commission has been vigilant and aggressive in preventing buyers and sellers from engaging in market manipulation to influence prices, and it would be fundamentally inconsistent for the Commission to design demand response compensation policies that coordinate and enforce such price manipulation.

27. Dr. Hogan argues that the ideal and economically efficient solution regarding demand response compensation is to implement retail real-time pricing at the LMP,

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[62] ISO-NE May 13, 2010 Comments at 3-4.

[63] Id. at 28.

thereby eliminating the need for demand response programs. Realizing that this is unattainable at the present time, Dr. Hogan goes on to propose a next-best solution, which he believes is to pay demand response compensation in the amount of LMP-G, or some amount that simulates explicit contract demand response (such as "buy-the-baseline" approach discussed below). These options, he argues, more than paying LMP, better support notions of comparability between demand response resources and generation.[64]

28. The New York Commission, however, argues that requiring payment of LMP-G would result in an administrative burden of tracking retail rates for the multiple utilities, ESCOs and power authorities and create undue confusion for retail customers and administrative difficulties for state commissions and ISOs and RTOs.[65]

29. Consistent with Dr. Hogan's arguments, some commenters assert that demand response providers should actually own or pay for electricity prior to, what commenters characterize as, an effective reselling of the electricity back to the market in the form of demand response. For example, these commenters suggest that the demand response provider purchase the power in the day-ahead market and resell it in the real-time

[64] Hogan Affidavit, ISO RTO Council May 13, 2010 Comments at 5.

[65] New York Commission May 13, 2010 Comments at 8.

markets.[66] EPSA argues that there must be some purchase requirement or representative offset to allow a demand response provider to "sell" a commodity that it owns to the ISO or RTO.[67] EPSA argues that such a requirement would send an efficient price signal, reduce incentives for gaming the system, and help address difficulties with measurement and verification of a demand reduction. EPSA highlights an ISO-NE IMM recommendation that, if the Commission permits LMP payment, it should also adopt a "buy-the-baseline" approach requiring demand response resources to purchase an expected amount of energy consumption in the day-ahead energy market and subsequently sell any demand reduction from that level in the real-time market.[68]

30. Viridity, on the other hand, argues that forcing customers to buy and then resell electricity will lead to too little demand response and that adopting a "buy-the-baseline" approach would constitute an inappropriate exercise of Commission authority to effectively force parties into contracts. Viridity and DR Supporters state that any characterization of demand response as a purchase and then resale of energy is erroneous[69] and based on the flawed assumption that demand response resources are

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[66] See, e.g., ISO-NE IMM May 13, 2010 Comments at 4-5; Midwest ISO TOs May 13, 2010 Comments at 14; PJM May 13, 2010 Comments at 5; and Duke Energy May 13, 2010 Comments at 2.

[67] EPSA June 30, 2010 Comments at 3.

[68] EPSA June 30, 2010 Comments at 23.

[69] Viridity Energy June 18, 2010 Comments at 25.

reselling energy. They state that the description of demand response as a reselling of energy has been correctly rejected by the Commission in EnergyConnect, where the Commission stated that it was establishing a policy of treating demand response as a service rather than a purchase and sale of electric energy.[70]

31. DR Supporters further argues that, despite claims to the contrary, paying full LMP to demand response providers does not constitute a subsidy for demand response any more than the remunerations of generators for the power that they sell. As Dr. Kahn states:

> Does this plan involve double compensation, as [Dr.] Hogan asserts, at the expense of power generators—of successful bidders promising to induce efficient demand curtailment and of consumers induced to practice it? Certainly not: the decrease in the revenue of the generators is (and consequent savings by consumers are) matched by the savings in their (marginal) costs of generating that power; the successful bidders for the opportunity to induce that consumer response are compensated for the costs of those efforts by the pool, whose (marginal) costs they save by assisting consumers to reduce their purchases.[71]

32. Viridity further disputes Dr. Hogan's argument that payment of LMP for demand response will distort an otherwise optimal market. Viridity posits that such arguments ignore dislocations in the wholesale power markets, the existence of market power that must be mitigated, imperfect information available to customers, barriers to entry and

[70] DR Supporters Aug. 30, 2010 Reply Comments at 10 (citing EnergyConnect, Inc., 130 FERC ¶ 61,031 at P 30-31 (2010)).

[71] DR Supporters Aug. 30, 2010 Reply Comments, Kahn Affidavit at 10.

uneconomic resources dispatched to fulfill must-run requirements.[72] Viridity further states that Dr. Hogan's arguments fail to acknowledge the limits of the Commission's jurisdiction and widespread dislocations and distortions in virtually all economic aspects of relevant energy markets (including fuels, facilities, pricing, environmental attributes, information and participation) and fail to account for any market benefits of demand response.[73] Finally, Viridity argues that Dr. Hogan's arguments fail to reflect the many complex interactions between price, equipment operational requirements, and customer processes, which point to a complex demand response decision.[74]

33. In addition to physical and economic comparability, some commenters contrast the environmental effects of generation and demand response resources. EDF notes that current market prices fail to internalize environmental externalities – including toxic air pollution, greenhouse gas pollution, and land and water use impacts – and other social costs. EDF asserts that the social impact of these environmental externalities is especially acute at peak times, positing that generation sources used for marginal supply at such times ("peaker plants") are among the oldest, dirtiest, and most inefficient in the

[72] Viridity June 18, 2010 Comments at 13 ("Importantly, Dr. Hogan (and others) in opposing the proposed rulemaking fails to acknowledge the limits of the Commission's jurisdiction, and wide spread dislocations and distortions in virtually all economic aspects of relevant energy markets (including fuels, facilities, pricing, environmental attributes, information and participation)." (Affidavit of John C. Tysseling, Ph.D.)).

[73] Viridity Reply Comments at 13.

[74] Viridity Reply Comments at 14.

fleet.[75] The American Clean Skies Foundation contends that fossil-fuel generators are typically mispriced because wholesale prices radically understate the full environmental and health costs associated with such generators.[76] Indeed, some commenters, such as Alcoa, argue that because demand response does not result in the external costs associated with generation (e.g., greenhouse gas emissions), instead resulting in less greenhouse gas emissions than generation, it should be compensated at more than LMP.[77]

34. Taking the opposite view concerning environmental externalities, EPSA states that paying LMP for demand response will merely encourage load to switch to off-grid power (or behind-the-meter generation), while still being compensated, and that such behind-the-meter generation produces more greenhouse gases and other air emissions than electricity from the regional energy market.[78]

35. Some commenters discuss comparability of generation and demand response in terms of the market rules that apply to each resource, arguing that both resources should be comparably compensated only if the same rules for participation apply to both resources, and both resources are held to the same standards for dispatchability.[79] They

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[75] EDF Oct. 13, 2010 Comments at 2.

[76] American Clean Skies Foundation May 13, 2010 Comments at 4.

[77] Alcoa May 13, 2010 Comments at 9.

[78] EPSA May 13, 2010 Comments at 60.

[79] ODEC May 13, 2010 Comments at 12; Westar May 13, 2010 Comments at 5-6.

also argue that similar penalty structures should apply to demand response resources as apply to generation, and that demand response participation must be subject to market monitoring.[80] Calpine adds that to the extent demand response resources are used and treated on par with generators for purposes of compensation, they should be subject to the same performance testing, penalties, and other similar requirements as generators.[81]

36. Some commenters address the comparability of demand response providers and generators in terms of maintaining system reliability. PIO argues that reductions in consumption provide additional reliability.[82] According to the NEMA, North American Electric Reliability Corporation (NERC) standards suggest that, from a reliability perspective, load reductions are equivalent or even superior to generator increases for balancing purposes. For example, while specific to the Western Interconnection, BAL-002-WECC-1 lists interruptible load as comparable to generation deployable within 10 minutes.[83] EPSA maintains that demand response resources are not full substitutes based on the nature of their participation and the rules applicable to each resource in the energy

[80] Id.

[81] Calpine May 13, 2010 Comments at 5.

[82] PIO May 13, 2010 Comments at 8.

[83] NEMA May 13, 2010 Comments at 2.

markets, pointing out, for example, that, unlike generators, demand response providers are not subject to regional and NERC mandatory reliability standards.[84]

37. On the other hand, PSEG argues that a MW of demand response does not make the same contribution towards system reliability as a MW of generation, because demand response committed as a capacity resource is only required to perform for a limited number of times over the peak period. PSEG refers to PJM's capacity market, for example, in which demand response only has to perform 10 times during the entire summer peak period, and then only for six hours per response. In contrast, PSEG argues, generators are available for dispatch, 24 hours a day, 365 days per year, except for a small percentage of time for forced and planned outages. PSEG further asserts that additional reliability standards - applicable to generating facilities, but not to demand response - increase the relative reliability value of generating resources to the system.[85]

**b) Appropriateness of a Net Benefits Test**

38. Some commenters assert that demand response providers should be paid LMP only when the benefits of demand response compensation outweigh the energy market costs to consumers of paying demand response resources, i.e., when cost-effective, as

[84] EPSA May 13, 2010 Comments at 7.

[85] PSEG May 13, 2010 Comments at 8.

determined by some type of net benefits or cost-effectiveness test.[86] They maintain that paying LMP for demand response in all hours, including off-peak hours, might not result in net benefits to customers, because the payments might be substantially more than the savings created by reducing the clearing price at that time.[87] According to these commenters, net benefits are most likely to be positive and greatest when the supply curve is steepest, which typically occurs in highest-cost, peak hours.[88] They argue that experience to date has shown positive benefits from demand response as a peak system resource, and that, during peak periods, the positive economics of demand response are generally very clear and a cost-benefit analysis may not be needed.[89] Furthermore, some commenters suggest that limiting the hours in which demand response resources are paid

[86] See generally May 13, 2010 Comments of NYSCPB; NECA; Capital Power; NECPUC; Maryland Commission; New York Commission; NSTAR; National Grid; NE Public Systems.

[87] Capital Power May 13, 2010 Comments at 5; P3 May 13, 2010 Comments at 5.

[88] NECPUC May 13, 2010 Comments at 13; see also Sept. 13, 2010 Tr. 13:6-19 (Mr. Keene); Maryland Commission May 13, 2010 Comments at 4-5.

[89] See, e.g., ACEEE Oct. 13, 2010 Comments 3-4. See also National Grid May 13, 2010 Comments at 4-5; NSTAR Electric Company (NSTAR) May 14, 2010 Comments at 3; Maryland Commission May 13, 2010 Comments, submitting Analysis of Load Payments and Expenditures under Different Demand Response Compensation Schemes at 10-11 (discussing PJM analysis showing that paying demand response providers LMP for all hours after compensating LSEs for lost revenues would not benefit customers in general but that positive economic benefits results when demand response providers receive LMP during at least the top 100 hours (the highest priced energy hours)).

LMP could help establish better baselines for measuring whether a demand response provider has, in fact, responded.[90]

39. Some commenters who oppose paying LMP in all hours for demand response also suggest various approaches, including net benefits tests, for determining when LMP should apply. The stated purpose of any of these tests would be to determine the point at which the incremental payment for demand response equals the incremental benefit of the reduction in load; payment of LMP would apply only up to that point.[91]

40. Opposition to use of a net benefits test comes from several directions. Numerous commenters, primarily industrial consumers and some consumer advocates, argue that a net benefits test will reduce competition,[92] have a "chilling effect" on the development of demand response,[93] and be costly and complex to implement.[94] Some commenters

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[90] See, e.g., CDWR May 13, 2010 Comments at 11; National Grid May 13, 2010 Comments at 8; ISO-NE May 13, 2010 Comments at 34; ACEEE Oct. 13, 2010 Comments 4. But see ISO-NE May 13, 2010 Comments at 32-33 (contending that no baseline estimation methodology that relies upon historical customer meter data can accurately and reliably estimate an individual customer's normal energy usage pattern if that customer responds frequently to price signals).

[91] NECAA May 13, 2010 Comments at 11; NYSCPB May 13, 2010 Comments at 5; National Grid May 13, 2010 Comments at 4-5.

[92] Viridity Oct. 13, 2010 Comments at 14.

[93] NAPP Oct. 13, 2010 Comments at 2.

[94] Viridity Oct. 13, 2010 Comments at 14; NAPP Oct. 13, 2010 Comments at 3; AMP Oct. 13, 2010 Comments at 4; CAISO Oct. 13, 2010 Comments at 5 and 16.

further state that no net benefits test is needed because the merit-order bid stack and market clearing function in a wholesale market, by definition, assures that the benefits to the system of demand response exceed the costs, and that the resource that clears is the lowest cost resource; otherwise, demand response would not dispatch ahead of competing alternatives.[95]

41. Another set of commenters argues that a net benefits test is unnecessary and inappropriate for different reasons.[96] These commenters assert that a net benefits test would be very costly and difficult to implement, that RTOs and ISOs cannot implement a net benefits test,[97] and that such a test is unnecessary with the economically efficient compensation level for demand response resources.[98] According to Andy Ott of PJM, "[t]he implicit assumption in developing a benefits test for purposes of compensation would be that you could actually determine individual customers, whether they benefitted

[95] EDF Oct. 13, 2010 Comments at 2; Viridity Oct. 13, 2010 Comments at 10; ELCON Oct. 13, 2010 Comments at 3.

[96] See, e.g., Oct. 13, 2010 Comments of: Midwest TDUs at 4-5; NEPGA at 8, NJBPU at 2-3; NAPP at 2-3; P3; SPP at 3-4; SDG&E, SoCal Edison, and PG&E at 4-6; Viridity Energy at 2; ELCON at 2; AMP at 2; CDWR at 1, 4-5; CAISO at 4, 15; Detroit Edison at 2; Smart Grid Coalition at 2; Duke Energy at 2; EDF at 2; FTC at 1; EPSA at 4; Indicated New York TOs at 3; Midwest ISO at 9; Steel Manufacturers Ass'n at 3.

[97] P3 Oct. 13, 2010 Comments at 5.

[98] Sept. 13, 2010 Tr. 155:21-24 (Mr. Robinson); Sept. 13, 2010 Tr. 141-42 (Mr. Centolella); Dr. Hogan Sept. 13, 2010 Comments at 5; Sept. 13, 2010 Tr. 60 (Dr. Shanker); Sept. 13, 2010 Tr. 27 (Mr. Newton); SDG&E May 13, 2010 Comments at 4.

or not. That type of analysis would be very costly to implement."[99] Midwest ISO TOs further assert that it would be difficult to prescribe by regulation the hours in which demand response provides net benefits because system conditions and load patterns change across seasons and over time.[100] NEPGA argues that compensating demand response resources at LMP whenever a reduction in consumption suppresses energy prices enough to provide net benefits to load is neither just and reasonable, nor in the public interest.[101] NEPGA states that the Commission recognized in Amaranth Advisors[102] that, if prices are suppressed below competitive, market levels, society as a whole is worse off. According to NEPGA, the goal is to get the right price—the economically efficient price produced by competitive markets.

42. NYISO posits that a rule mandating payment of LMP-G avoids the need to develop a net benefits test. NYISO further states, however, that if the Commission decides to move forward with LMP for demand response, it should craft a net benefits test that minimizes any opportunities for distorting market prices or exploiting market inefficiencies. Citing support for Dr. Hogan's arguments, NYISO states that "a net benefits test should ensure that the demand response program does not have negative net

[99] Sept. 13, 2010 Tr. 19 (Mr. Ott).

[100] Midwest ISO TOs May 13, 2010 Comments at 16.

[101] NEPGA June 21, 2010 Comments at 1-2.

[102] 120 FERC ¶ 61,085 (2007).

benefits compared to no program at all. The criterion to apply would focus on the bid-cost savings of generation and load, with the load bids adjusted for the effects of avoidance of the retail rate."[103]

**c) Standardization or Regional Variations in Compensation**

43. With regard to potential regional variations for compensation mechanisms across RTO and ISO markets, many commenters, mostly those in support of the NOPR's proposed compensation level, endorse standardization.[104] Some parties, primarily industrial customers and some customer advocates, argue that, regardless of location, both demand response providers and generators provide a comparable service in terms of balancing supply and demand, as discussed above, and therefore should be comparably compensated at the LMP.[105] They argue that fair, non-discriminatory markets must adapt and eliminate barriers to entry to the use and incorporation of traditional and non-

[103] NYISO Oct. 13, 2010 Comments at 3-4.

[104] See May 13, 2010 Comments of: ArcelorMittal; Alcoa; ACENY; ACC; AFPA; CDWR; Mayor Bloomberg; Consert; CDRI; CPower; DR Supporters; Derstine's; Durgin; Electricity Committee; ELCON; Electrodynamics; ECS; EnerNOC; ICUB; IECA; IECPA; Irving Forest; Joint Consumers; Limington; Madison Paper; Massachusetts AG; NEMA; National Energy; National League of Cities; NJBPU; NAPP; Occidental; Okemo; Partners; Pennsylvania Department of Environment; Pennsylvania Commission; Rep. Chris Ross; Precision; PRLC; Raritan ; SDEG, SoCal; PG&E; Schneider; Governor O'Malley; Steel Manufacturers Ass'n; Verso; Viridity; Virginia Committee; Wal-Mart; Waterville.

[105] See, e.g., Steel Manufacturers Ass'n May 13, 2010 Comments at 12; NEMA May 13, 2010 Comments at 5.

traditional resources—where non-traditional resources include actively-managed demand—in the dispatch and management of the electric system.[106] They further posit that the lack of a unified policy itself represents a regulatory barrier to demand response,[107] and that a consistent set of rules reduces the costs and complexities of demand response participation and facilitates training and transfer of personnel across regions.[108] To that end, many commenters argue that adopting a unified approach to demand response compensation at the LMP, as opposed to allowing regional variation including payment of something less than LMP, is necessary to overcome the barriers to entry of demand response providers.[109] Reciting the many benefits of demand reductions in energy use, these commenters support a compensation level that will provide a catalyst for private sector engagement in improved energy management practices. Viridity argues that the near absence of demand response participating in energy markets is powerful empirical proof that current, varying levels of compensation are inadequate—especially

[106] Steel Manufacturers Ass'n May 13, 2010 Comments at 12.

[107] PIO May 13, 2010 Comments at 9; DR Supporters Aug. 30, 2010 Comments at 6-7.

[108] See, e.g., Alcoa May 13, 2010 Comments at 13.

[109] NECPUC May 13, 2010 Comments at 4; NYISO May 13, 2010 Comments at 16.

in markets that start with a market-based level of compensation and then reduce it by the generation portion of a customer's retail rate (LMP – G).[110]

44. Other commenters caution against standardizing the compensation level for demand response, pointing to regional differences in market structure, state regulatory environment, and resource mix.[111]

### 3. Commission Determination

45. The Commission acknowledges the diverging opinions of commenters regarding the appropriate level of compensation for demand response resources. As discussed above, commenters are split on this issue, with some in favor of paying the LMP for demand reductions in the day-ahead and real-time energy markets in all hours, others arguing that paying the LMP for demand reductions under any conditions will result in over-compensation or distortions in incentives to reduce consumption, and still others arguing that paying the LMP for demand reductions is only appropriate when it is reasonably certain to be cost-effective.

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[110] Viridity Energy May 13, 2010 Comments at 4.

[111] See, e.g., May 13, 2010 Comments of: ConEd at 3-4; Consumers Energy at 2; California Commission at 9; CMEEC at 2-3, 14-15; Detroit Edison at 3-5; Dominion at 8; Duke Energy at 4; EPSA at 6; Hess at 4; Indicated New York TOs at 3; Maryland Commission at 5; Midwest TDUs at 2, 6; Midwest ISO TOs at 16; National Grid at 5-6; 11-12; New York Commission at 4, 11; NCPA at 3; NYISO at 2-3; ODEC at 27; PJM at 5-6; SPP at 1.

46. In the face of these diverging opinions, the Commission observes that, as the courts have recognized, "'issues of rate design are fairly technical and, insofar as they are not technical, involve policy judgments that lie at the core of the regulatory mission.'"[112] We also observe that, in making such judgments, the Commission is not limited to textbook economic analysis of the markets subject to our jurisdiction, but also may account for the practical realities of how those markets operate.[113]

47. As discussed further below, the Commission agrees with commenters who support payment of LMP under conditions when it is cost-effective to do so, as determined by the net benefits test described herein.[114] We have previously accepted a variety of ISO and RTO proposals for compensation for demand response resources participating in

[112] Elec. Consumers Res. Council v. FERC, 407 F.3d 1232, 1236 (D.C. Cir. 2005) (quoting Pub. Util. Comm'n of the State of Cal. v. FERC, 254 F.3d 250, 254 (D.C. Cir. 2001)); see also Town of Norwood v. FERC, 962 F.2d 20, 22 (D.C. Cir. 1992).

[113] See Elizabethtown Gas Co. v. FERC, 10 F.3d 866, 872 (D.C. Cir. 1993) ("It is the FERC's established policy to consider equitable factors in designing rates, and to allow for phasing in of changes where appropriate. . . . It is hardly arbitrary or capricious so to temper the dictates of theory by reference to their consequences in practice."); Vermont Dep't of Pub. Serv. v. FERC, 817 F.2d 127, 135 (D.C. Cir. 1987) ("Indeed, 'the congressional grant of authority to the agency indicates that the agency's interpretation typically will be enhanced by technical knowledge.'" (quoting Nat'l Fuel Gas Supply Corp. v. FERC, 811 F.2d 1563, 1570 (D.C. Cir. 1987))); Columbia Gas Transmission Corp. v. FERC, 750 F.2d 105, 112 (D.C. Cir. 1984) ("the Commission is vested with wide discretion to balance competing equities against the backdrop of the public interest").

[114] See generally May 13, 2010 Comments of NYSCPB; NECA; Capital Power; NECPUC; Maryland Commission; New York Commission; NSTAR; National Grid; NE Public Systems.

organized wholesale energy markets. We find, based on the record here that, when a demand response resource has the capability to balance supply and demand as an alternative to a generation resource, and when dispatching and paying LMP to that demand response resource is shown to be cost-effective as determined by the net benefits test described herein, payment by an RTO or ISO of compensation other than the LMP is unjust and unreasonable. When these conditions are met, we find that payment of LMP to these resources will result in just and reasonable rates for ratepayers.[115] As stated in the NOPR, we believe paying demand response resources the LMP will compensate those resources in a manner that reflects the marginal value of the resource to each RTO and ISO.[116]

48. The Commission emphasizes that these findings reflect a recognition that it is appropriate to require compensation at the LMP for the service provided by demand response resources participating in the organized wholesale energy markets only when two conditions are met:

- The first condition is that the demand response resource has the capability to provide the service , i.e., the demand response resource must be able to displace a

[115] The Commission's findings in this Final Rule do not preclude the Commission from determining that other approaches to compensation would be acceptable when these conditions are not met.

[116] NOPR at P 12.

generation resource in a manner that serves the RTO or ISO in balancing supply and demand.

- The second condition is that the payment of LMP for the provision of the service by the demand response resource must be cost-effective, as determined by the net benefits test described herein.

49. With respect to the first, capability-related condition, we note that a power system must be operated so that there is real-time balance of generation and load, supply and demand. An RTO or ISO dispatches just the amount of generation needed to match expected load at any given moment in time. The system can also be balanced through the reduction of demand.[117] Both can have the same effect of balancing supply and demand at the margin either by increasing supply or by decreasing demand.

50. With respect to the second cost-effectiveness condition, the record leads us to alter the proposal set forth in the NOPR in this proceeding. As various commenters explain, dispatching demand response resources may result in an increased cost per unit to load

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[117] Andrew L. Ott Sept. 13, 2010 Statement at 1.

> Economic and Capacity-based demand response clearly provides benefits to regional grid operation and the wholesale market operation. . . . These demand resources provide benefits by providing valuable alternatives to PJM in maintaining operational reliability and in promoting efficient market operations.

Id. at 1; see also CDRI May 13, 2010 Comments at 10; CDWR May 13, 2010 Comments at 5; NJPBU May 13, 2010 Comments at 2.

associated with the decreased amount of load paying the bill, depending on the change in LMP relative to the size of the energy market. As stated above, this is the billing unit effect of dispatching demand response resources.[118] However, when reductions in LMP from implementing demand response results in a reduction in the total amount consumers pay for resources that is greater than the money spent acquiring those demand response resources at LMP, such a payment is a cost-effective purchase from the customers' standpoint.[119] In comparison, when wholesale energy market customers pay a reduced price attributable to demand response that does not reduce total costs to customers more than the costs of paying LMP to the demand response dispatched, customers suffer a net loss. Implementation of the net benefits test described herein will allow each RTO or ISO to distinguish between these situations.

51. This billing unit effect and the net benefits test through which it is addressed herein, warrant more detailed discussion. In the organized wholesale energy markets, the economic dispatch organizes offers from lowest to highest bid in order to balance supply

[118] As stated above, dispatching generation resources does not produce this billing unit effect because it does not result in a decrease of load.

[119] As a simple example, assume a market of 100 MW, with a current LMP of $50/MWh without demand response, and an LMP of $40/MWh if 5 MW of demand response were dispatched. Total payments to generators and load would be $4,000 with demand response compared to the previous $5,000. Even though, the reduced LMP is now being paid by less load, only 95 MW compared to 100 MW, the price paid by each remaining customer would decrease from $50/MWh to $42.11/MWh ($4,000/95). Therefore, the payment of LMP to demand resources is cost-effective.

and demand, taking into account other parameters such as requirements for a generator to operate at a minimum level of output or minimum amount of time, reserve requirements and so forth. With dispatch of a demand response resource, the load also goes down, that is, the level of remaining load falls. However, the "supply" of resources deployed—which includes both generation and demand response—does not fall. The total costs to the system for these resources must then be allocated among the reduced quantity of remaining load.

52. In the absence of the net benefits test described herein, the RTO's or ISO's economic dispatch ordinarily would select demand response when it is the incremental resource with the lowest bid. However, if the next unit of generation is not sufficiently more expensive than the demand response resource, the decrease in LMP multiplied by the remaining load would not be greater than the costs of dispatching the demand response resource. In this situation, dispatching the demand response resource would result in a higher price to remaining customers than the dispatch of the next unit of generation in the bid stack. While the demand response resource appears cost competitive in the dispatch order, selection of the demand response resource increases the total cost per unit to remaining load, and it would not be cost-effective to dispatch the demand response resource.

53. For this reason, the billing unit effect associated with dispatch of a demand response resource in an energy market must be taken into account in the economic comparison of the energy bids of generation resources and demand response resources. Therefore, rather than requiring compensation at LMP in all hours, the Commission requires the use of the net benefits test described herein to ensure that the overall benefit of the reduced LMP that results from dispatching demand response resources exceeds the cost of dispatching those resources. When the above-noted conditions of capability and of cost-effectiveness are met, it follows that demand response resources that clear in the day-ahead and real-time energy markets should receive the LMP for services provided, as do generation resources. LMP represents the marginal value of an increase in supply or a reduction in consumption at each node within an ISO or RTO, i.e., LMP reflects the marginal value of the last unit of resources necessary to balance supply and demand. Indeed, LMP has been the primary mechanism for compensating generation resources clearing in the organized wholesale energy markets since their formation. [120]

54. The Commission finds that demand response resources that clear in the day-ahead and real-time energy markets should receive the same market-clearing LMP as compensation in the organized wholesale energy markets when those resources meet the conditions established here as a cost-effective alternative to the next highest-bid

[120] See DR Supporters Aug. 30, 2010 Reply Comments (Kahn Affidavit at 2 (footnote omitted)).

generation resources for purposes of balancing the energy market. We discuss below the comments filed on these issues.

55. Some commenters dispute that the foregone consumption of energy by demand response resources performs the service of balancing supply and demand in the energy market as would energy supplied by generators in the day-ahead and real-time energy markets, arguing that it is inappropriate to pay electric consumers to not consume.[121] The Commission disagrees. Generation and load must be balanced by the RTOs and ISOs when clearing the day-ahead and real-time energy markets, and such balancing can be accomplished by changes in either supply or demand. The Commission finds that in the organized wholesale energy markets demand response can balance supply and demand as can generation.

56. Commenters that oppose this finding do not adequately recognize a distinctive and perhaps unique characteristic of the electric industry. The electric industry requires instantaneous balancing of supply and demand at all times to maintain reliability. It is in this context that the Commission finds that demand response can balance supply and demand as can generation when dispatched, in the organized wholesale energy markets.

[121] See, e.g., ISO-NE May 13, 2010 Comments at 3; APPA May 13, 2010 Comments at 12; Capital Power May 13, 2010 Comments at 2; EPSA May 13, 2010 Comments at 72.

57. Due to a variety of factors, demand responsiveness to price changes is relatively inelastic in the electric industry and does not play as significant a role in setting the wholesale energy market price as in other industries. The Commission has recognized that barriers remain to demand response participation in organized wholesale energy markets. For example, in Order No. 719, the Commission stated:

> [D]espite previous Commission and RTO and ISO efforts to facilitate demand response, regulatory and technological barriers to demand response participation persist, thereby limiting the benefits that would otherwise result. A market functions effectively only when both supply and demand can meaningfully participate, and barriers to demand response limit the meaningful participation of demand in electricity markets.[122]

Barriers to demand response participation at the wholesale level identified by commenters include the lack of a direct connection between wholesale and retail prices,[123] lack of dynamic retail prices (retail prices that vary with changes in marginal wholesale costs), the lack of real-time information sharing, and the lack of market incentives to invest in enabling technologies that would allow electric customers and

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[122] Order No. 719, FERC Stats. & Regs. ¶ 31,281 at P 83 (citing Federal Energy Regulatory Commission Staff, A National Assessment of Demand Response Potential (June 2009), found at http://www.ferc.gov/legal/staff-refports/06-09-demand-response.pdf; Barriers to Demand Side Response in PJM (2009)). In compliance filings submitted by RTOs and ISOs and their market monitors pursuant to Order No. 719, as well as in responsive pleadings, parties have mentioned additional barriers, such as the inability of demand response resources to set LMP, minimum size requirements, and others.

[123] See, e.g., Monitoring Analytics May 13, 2010 Comments at 4-6.

aggregators of retail customers to see and respond to changes in marginal costs of providing electric service as those costs change. For example, Dr. Kahn states:

> These circumstances—specifically, the fact that pass-through of the LMP is costly and (perhaps) politically infeasible, the possibly prohibitive cost of the metering necessary to charge each ultimate user, moment-by-moment, the often dramatic changes in true marginal costs for each—can justify direct payment at full LMP to distributors and ultimate customers who promise to guarantee their immediate response to such increases in true marginal costs of supplying them.[124]

Furthermore, EnerNOC states:

> On a more fundamental level, the inadequate compensation mechanisms in place today in wholesale energy markets fail to induce sufficient investment in demand response resource infrastructure and expertise that could lead to adequate levels of demand response procurement. Without sufficient investment in the development of demand response, demand response resources simply cannot be procured because they do not yet exist as resources. Such investment will not occur so long as compensation undervalues demand response resources.[125]

58. The Commission concludes that paying LMP can address the identified barriers to potential demand response providers.

59. Removing barriers to demand response will lead to increased levels of investment in and thereby participation of demand response resources (and help limit potential

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[124] DR Supporters Sept. 16, 2009 Comments filed in Docket No. EL-09-68-000 (Kahn Affidavit at 6). See also id. at 4 (Customers offering to reduce consumption should be induced "to behave as they would if market mechanisms alone were capable of rewarding them directly for efficient economizing.").

[125] EnerNOC May 13, 2010 Comments at 4; see also Alcoa May 13, 2010 Comments at 4; Viridity May 13, 2010 Comments at 5-6.

generator market power), moving prices closer to the levels that would result if all demand could respond to the marginal cost of energy. To that end, the Commission emphasizes that removing barriers to demand response participation is not the same as giving preferential treatment to demand response providers; rather, it facilitates greater competition, with the markets themselves determining the appropriate mix of resources, which may include both generation and demand response, needed by the RTO and ISO to balance supply and demand based on relative bids in the energy markets. In other words, while the level of compensation provided to each resource affects its willingness and ability to participate in the energy market, ultimately the markets themselves will determine the level of generation and demand response resources needed for purposes of balancing the electricity grid.[126]

60. Another issue raised by a number of commenters, largely representing generators, is whether a lower payment based on LMP-G is the economically-efficient price that sends the proper price signal to a potential demand response provider. These commenters argue that, by not consuming energy, demand response providers already effectively receive "G," the retail rate that they do not need to pay. They therefore contend that demand response providers will be overcompensated unless "G" is deducted from

[126] Generation and demand response resources have the potential to earn other revenues through bilateral arrangements, capacity markets where they exist, and ancillary services.

payments made by the RTO or ISO for service in the wholesale energy market, resulting in a payment of LMP-G. These commenters suggest that payment of LMP-G will result in a price signal to demand response providers equivalent to the LMP (i.e., (LMP - G) + G). Similarly, some commenters argue that paying demand response resources the LMP will lead to a wholesale electricity price that is not economically efficient.[127]

61. The Commission disagrees with commenters who contend that demand response resources should be paid LMP-G in all hours. First, as discussed above, demand response resources participating in the organized wholesale energy markets can be cost-effective, as determined by the net benefits test described herein, for balancing supply and demand and, in those circumstances, it follows that the demand response resource should also receive compensation at LMP. Second, such comments largely rely on arguments about economic efficiency, analogizing to incentives for individual generators to bid their marginal cost. These arguments fail to acknowledge the market imperfections caused by the existing barriers to demand response, also discussed above. In Order No. 719, the Commission found that allowing demand response to bid into organized wholesale energy markets "expands the amount of resources available to the market, increases competition, helps reduce prices to consumers and enhances reliability."[128]

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[127] See NEPGA June 21, 2010 Comments at 1-2.

[128] Order No. 719, FERC Stats. & Regs. ¶ 31,281 at P 154.

Furthermore, Dr. Kahn argues that paying demand response LMP sets "up an arrangement that treats proffered reductions in demand on a competitive par with positive supplies; but the one is no more a [case of overcompensation] than the other: the one delivers electric power to users at marginal costs—the other—reductions in cost—both at competitively-determined levels."[129]

62. Several other considerations also support this Commission conclusion. In the absence of market power concerns, the Commission does not inquire into the costs or benefits of production for the individual resources participating as supply resources in the organized wholesale electricity markets and will not here, as requested by some commenters, single out demand response resources for adjustments to compensation. The Commission has long held that payment of LMP to supply resources clearing in the day-ahead and real-time energy markets encourages "more efficient supply and demand decisions in both the short run and long run,"[130] notwithstanding the particular costs of production of individual resources. Commenters have not justified why it would be appropriate for the Commission to continue to apply this approach to generation resources yet depart from this approach for demand response resources.

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[129] DR Supporters Aug. 30, 2010 Reply Comments (Kahn Affidavit at 9-10).

[130] See New England Power Pool, 101 FERC ¶ 61,344, at P 35 (2002).

63. In addition, we agree with the New York Commission that given the differences in retail rate structures across RTO footprints and even within individual states, requiring ISOs and RTOs to incorporate such disparate retail rates into wholesale payments to wholesale demand response providers would, even though perhaps feasible, create practical difficulties for a number of parties, including state commissions and ISOs and RTOs. Moreover, incorporating such rates could result in customer uncertainty as to the prevailing wholesale rate.

64. Some arguments advocating paying LMP-G rather than LMP are based on an assumption that demand response resources need to purchase the energy in day-ahead markets or by other means and then "resell" the energy to the market in the form of demand response. However, as the Commission previously stated in EnergyConnect, the Commission does not view demand response as a resale of energy back into the energy market. [131] Instead, as the Commission also explained in EnergyConnect and in Order No. 719-A, the Commission asserts jurisdiction with respect to demand response in organized wholesale energy markets because of the effect of demand response and related RTO and ISO market rules on Commission-jurisdictional rates. [132]

[131] See EnergyConnect, 130 FERC ¶ 61,031 at P 32.

[132] Id.; see also Order No. 719-A, FERC Stats. & Regs. ¶ 31,292, at P 47.

65. With regard to the "buyers' cartel" argument, the Commission disagrees that market rules establishing circumstances in which particular resources can participate and receive the LMP represents cooperative price setting. RTOs and ISOs evaluate the bids from generation and demand response resources to establish the order of dispatch which secures the most economical supplies needed, consistent with the reliability constraints imposed on the system. Imposing a cost-effectiveness condition does not convert this unit commitment process by the RTO or ISO into collusion among bidders, whether generation or demand response. Furthermore, the market rules administering such a program would be approved by this Commission and demand response resources would be subject to Commission-approved rules, just like any other participants in the organized wholesale energy markets. In addition, arguments that the subject of this proceeding is equivalent to the types of market manipulation investigated in Amaranth and ETP are groundless and without merit. In Amaranth, the trader was accused of engaging in a fraudulent scheme with scienter in connection with a jurisdictional transaction. Here, there is no such allegation, merely speculation that the Commission is somehow facilitating coordination of demand- side bidders in order to lower prices.

66. Some commenters argue that demand response providers and generators should both be compensated at the market clearing price only if both are subject to the same market participation rules, penalty structures, testing requirements, and market monitoring provisions. The ISOs and RTOs already consider how to ensure

comparability between demand response and generation in terms of market rules.[133] The Commission agrees that as a general matter demand response providers and generators should be subject to comparable rules that reflect the characteristics of the resource, and expect ISOs and RTOs to continue their evaluation of their existing rules in light of this Final Rule and make appropriate filings with the Commission.

67. Some commenters argue that the Commission should not impose a single pricing rule due to differences in market structure, state regulatory environment, and resource mix among the ISOs and RTOs. While such differences may exist, the commenters have not shown why such differences warrant a different compensation level among the ISOs and RTOs. As discussed above, regardless of the resource mix or the state regulatory environment, demand response, which satisfies the net benefits test described herein and can balance the system, is a cost-effective alternative to generation in the organized wholesale energy markets, and payment of LMP represents the marginal value of a decrease in demand.

[133] See PJM Interconnection, L.L.C., 129 FERC ¶ 61,081 (2009).

### B. Implementation of a Net Benefits Test

#### 1. Comments

68. In response to questions that the Commission posed in the Supplemental NOPR, some commenters advocate a net benefits trigger based on a particular price threshold.[134] The NYISO currently has a static bid threshold of $75/MWh in its day-ahead demand response program.[135]

69. However, other commenters assert that using a static threshold based on historical data misses the changes that occur within electricity markets across seasons and years, and that it is erroneous to assume that all demand response occurring above a certain threshold price (for instance, at the very highest loads or highest priced hours) will result in lower costs to wholesale customers and that demand response is not cost-effective at

[134] For example, National Grid states that the threshold could be triggered by a particular price on the supply offer curve at which the additional cost of paying LMP to demand response resources is most likely to be outweighed by LMP reductions in the wholesale energy market as a result of the demand reductions produced by these resources. National Grid May 13, 2010 Comments at 6. Those in favor of a price threshold include National Grid (but allow the ISO or RTO to identify threshold based on analysis); NE Public Systems; NECPUC; ISO-NE (minimum offer price based on fixed heat rate, times a fuel price index); New York Commission (supports ISO-NE's heat rate indexed price threshold).

[135] NYISO implements a day-ahead demand response program by which resources bid into the market at a minimum of $75/MWh and can get paid the LMP. See section 4.2.2.9 ("Day-Ahead Bids from Demand Reduction Providers to Supply Energy from Demand Reductions") of NYISO's Market Services Tariff.

prices below the static threshold price.[136] They argue that a static threshold offer price cannot easily adjust with changing energy market prices which may result in inefficient dispatch of demand resources, excluding demand response participation in hours when demand response can provide beneficial savings and including demand response participation in hours when there are no beneficial savings.[137] The New York Commission supports a dynamic, rather than a static bid threshold, arguing that, while a static bid threshold helps prevent demand response providers from gaming the system by seeking compensation for reducing electricity consumption for reasons other than market prices, it can also limit participation in a demand response program because prices might not exceed the threshold on a consistent basis.[138]

70. In a similar vein, some commenters suggest utilizing a dynamic bid threshold for determining when LMP payment would apply.[139] For example, NECPUC favors use of a dynamic mechanism such as a price threshold based on a preset heat rate of marginal

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[136] Sept. 13, 2010 Tr. 52-53 (Mr. Peterson); Massachusetts AG Oct. 13, 2010 Comments at 23.

[137] Massachusetts AG Oct. 13, 2010 Comments (attachment, Demand Response Potential in ISO New England's Day-Ahead Energy Market, Synapse Energy Economics, Inc. Oct. 11, 2010 at 9). See generally, NECPUC May 13, 2010 Comments at 18.

[138] Id.

[139] National Grid May 13, 2010 Comments at 6; New York Commission May 13, 2010 Comments at 10; Viridity May 13, 2010 Comments at 24. See generally NECPUC, New York Commission; ISO-NE; NSTAR; ACEEE; and NYSCPB Oct. 13, 2010 Comments.

generation and fuel price, like that currently used in New England's Day-Ahead Load Response Program (DALRP),[140] for the ISO-NE control area.[141] National Grid suggests a trigger, determined by each ISO or RTO, using a particular price on the supply offer curve at which the additional cost of paying LMP to demand resources is most likely to be outweighed by LMP reductions in the wholesale energy market as a result of the demand reductions.[142]

71. Still other commenters urge compensating demand response during an ISO- or RTO-defined period of critical high-cost hours in which it is cost-effective to pay LMP. These commenters argue that the effect of demand response on the market clearing price is greatest during a limited number of hours during the year.[143] Therefore, identifying the hours in which to pay LMP to demand response resources could be used as a cost-effective net benefits test with potential savings for ratepayers. According to PJM,

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[140] The DALRP establishes a minimum offer price by approximating the variable cost component, in the form of a fuel cost, of a hypothetical peaking unit sufficiently high enough in the supply stack to ensure net benefits. On a monthly basis, this minimum offer price is reset to reflect the product of an appropriate fuel price index and a proxy heat rate. See NECPUC Oct. 13, 2010 Comments at 15.

[141] NECPUC Oct. 13, 2010 Comments at 14-16; NECPUC May 13, 2010 Comments at 17.

[142] Id. at 5-6.

[143] Maryland Commission May 13, 2010 Comments at 4-5; see generally NSTAR, ACEEE and NYSCPB Oct. 13, 2010 Comments.

further analysis is needed to ascertain the critical high-cost hours in which it will be cost-effective to pay full LMP for demand response.[144]

72. The Consumer Demand Response Initiative (CDRI) proposes a mechanism for determining what demand response resources are cost-effective in any hour.[145] This dispatch algorithm tests whether the money necessary to compensate demand response is less than the cost savings due to the decreased market-clearing price resulting from implementing demand response. In a sense, it is a dynamic cost/benefit analysis built into the dispatch algorithm. This cost/benefit analysis accounts for the billing unit effect. The billing unit effect occurs when demand response resources are dispatched to balance the system; the associated reduction in load results in fewer MWh of realized load (demand) paying for the sum of generator and demand response resource MWh, so load pays an effective rate which is greater than the LMP set to procure resources. Some commenters assert that if the Commission finds that a net benefits test is needed, it should

[144] Maryland Commission May 13, 2010 Comments at 4 n.9.

[145] The approach submitted by CDRI was developed for implementation in the ISO-NE day-ahead energy market. The discussion here is generalized to be applicable to any energy market that uses security-constrained economic dispatch to select the least-cost resources and establish a market-clearing price.

require organized wholesale energy market operators to implement a proposal similar to that submitted by CDRI.[146]

73. Under the proposal submitted by CDRI, the demand response bids are part of the supply stack to which a security-constrained economic dispatch process is applied. All demand response bids that result in a lower price to customers, including consideration of the reduced number of billing units, are selected while those bids that raise the price, as compared to selecting the next generation bid in the supply stack, are not. This dispatch algorithm, as proposed, would be used by the ISO or RTO to determine a revised LMP that would be charged to load. The revised LMP creates a surplus (or over-collection) of revenue for the ISO or RTO that is then distributed to the LSEs through a settlement algorithm with the goal of holding LSEs harmless.[147]

74. During the September 2010 Technical Conference, Dr. Ethier of ISO-NE stated that a dynamic net benefits test done on an hourly basis that examines the effect of the demand response resource on LMPs, similar to that proposed by CDRI, would become

[146] PIO July 27, 2010 Comments at 6; Massachusetts AG Oct. 13, 2010 Comments at 11; Viridity Oct. 13, 2010 Comments at 2. See CDRI May 13, 2010 Comments for a full description of the algorithms.

[147] CDRI May 13, 2010 Comments Attachment B at 18. CDRI states that the dispatch and settlement algorithms "could be employed to evaluate dispatch and assure customer benefits, without being employed to perform allocations and settlements." CDRI Oct. 13, 2010 Comments at 4.

very complicated to implement and require essentially an iterative process.[148] Dr. Ethier states that the ISO would have to run the dispatch model to formulate a base LMP with no demand response and then re-run it with demand response in the market; however those two iterations alone do not "cover the whole waterfront" in terms of the possible iterations required. According to Dr. Ethier, the ISO could dispatch too much demand response the first time, or if the ISO first rejected dispatching demand response, it may need to go back and dispatch smaller amounts of demand response to determine what would happen to the LMPs. Dr. Ethier stated that it is unclear where the ISO would stop the iteration of testing the impact on LMPs of dispatching demand response.[149] Andy Ott of PJM also stated during the technical conference that implementing a net benefits test would entail an iterative process that would be costly and difficult, if the RTO could even do it.[150]

75. Other commenters do not support the use of a net benefits test, but state that if one is adopted it should be based on general principles that RTOs and ISOs must apply to their systems in determining when LMP payments will apply.[151] A few commenters

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[148] Sept. 13, 2010 Tr. 80-81 (Dr. Ethier).

[149] Id.

[150] Sept. 13, 2010 Tr. 82:16-21 (Mr. Ott).

[151] See generally AEP, Midwest ISO, Occidental, NYISO, Constellation Oct. 13, 2010 Comments.

articulated specific criteria to be used in a net benefits test.[152] AEP believes that the objective of an incentive payment for demand response resources on the basis of broad market benefits can be achieved through a review of the costs and benefits of individual providers. Constellation states that any net benefits test should be based on the difference between the value consumers receive from energy and the cost of energy production.[153]

76. ISO-NE argues that a net benefits test should be based on economic efficiency, the sum of producer and consumer surplus, which suggests that demand response incentives ought to be provided to encourage demand reductions when the cost of energy production exceeds the value of consumption, and to encourage usage when the cost of energy production is less than the value of consumption. ISO-NE further states that a net benefits test that focuses solely on consumer savings ignores the value lost by consumers when energy consumption levels are reduced in response to incentive payments. ISO-NE posits that any variant of a LMP payment should be limited to a very small number of

[152] See, e.g., Midwest ISO October 13, 2010 Comments at 9-14 and Table 1 (setting forth comprehensive list of benefits and costs of demand response by type of market participants); Occidental October 13, 2010 Comments at 4-5 (any net benefits test must take into consideration offsetting variables, such as higher LMPs in the subsequent periods where demand rebound increases market price, and capacity market price effects); AEP October 13, 2010 Comments at 3-4 (AEP does not recommend the use of a societal benefits component (i.e., health, environment, or employment efforts)).

[153] Constellation October 13, 2010 Comments at 3-4.

high-priced hours to minimize the economic distortions and avoid significant administrative complexities.[154]

77. A few commenters state that policies affecting energy prices will also impact capacity prices because generation owners with fixed costs must raise capacity price offers to remain financially viable at lower energy prices.[155] ISO-NE and Pepco argue, therefore, that the Commission should adopt a net benefits test that considers the impact of demand response compensation on both energy and capacity markets.[156] According to ISO-NE, when considering capacity market impacts under full-LMP compensation, long-term increases in capacity prices in response to suppressed LMPs offset consumer savings and leaves consumers worse off over time.[157] Robert Weishaar of the DR Supporters argues that properly compensating demand response should flatten the load profile and decrease the forecast of load projections, which would reduce capacity clearing prices.[158] Donald Sipe of CDRI adds that to the extent that scarcity revenues are

[154] ISO-NE Oct. 13, 2010 Comments at 4-5 and 21.

[155] See, e.g., Sept. 13, 2010 Tr. 94:13-22 (Dr. Shanker); Sept. 13, 2010 Tr. 98:4-24 (Mr. Peterson); Sept. 13, 2010 Tr. 99:2-7 (Mr. Sunderhauf); ISO-NE Oct. 13, 2010 Comments at 5.

[156] Sept. 13, 2010 Tr. 99:1-24 (Mr. Sunderhauf); ISO-NE Oct. 13, 2010 Comments at 5.

[157] ISO-NE Oct. 13, 2010 Comments at 6.

[158] Sept. 13, 2010 Tr. 103-104 (Mr. Weishaar).

not sufficient, capacity markets are designed to ensure that a generator's capital costs are recovered; in a forward market that looks ahead as load adjusts, one can see whether a resource is performing or not. For purposes of long-run reliability, he argues, as long as compensation is in the amount that is necessary to induce new investment and reflects market value, the argument that demand response in the bid stack will push out generators is only true if generators are higher priced than the consumer resources that are brought by demand response.[159]

### 2. Commission Determination

78. For the reasons discussed previously, the Commission is requiring each RTO and ISO to implement the net benefits test described herein to determine whether a demand response resource is cost-effective. More specifically, the Commission is adopting two distinct requirements with respect to the net benefits test. While we find that the integration of the billing unit effect into the RTO/ISO dispatch processes has the potential to more precisely identify when demand response resources are cost-effective, we also recognize and understand the position of several of the RTOs and ISOs that modification of their dispatch algorithms may be difficult in the near term. Given these technical difficulties, we will require to RTOs and ISO to perform (1) the net benefits test described below to determine on a monthly basis under which conditions it is cost-

[159] Sept. 13, 2010 Tr. 106:16-24 (Mr. Sipe).

effective to pay full LMP to demand resources; [160] and (2) a study of the feasibility of developing a mechanism for determining the cost-effective dispatch of demand resources.

79. First we direct each RTO and ISO to undertake an analysis on a monthly basis, based on historical data and the RTO's or ISO's previous year's supply curve, to identify a price threshold to estimate where customer net benefits, as defined herein, would occur. The RTO or ISO should determine the threshold price corresponding to the point along the supply stack for each month beyond which the benefit to load from the reduced LMP resulting from dispatching demand response resources exceeds the increased cost to load associated with the billing unit effect, and update the calculation monthly. The ISOs and RTOs are to determine monthly threshold prices based on historical data. The threshold prices would be updated monthly as new data becomes available and posted on the RTO web site. For example, the RTO should conduct an analysis of supply curves for January through December 2010 to be used as a starting point to establish threshold prices for 2011. Those numbers would be updated monthly during 2011 for significant changes in resource availability and fuel prices, with the process repeated monthly to reflect that

[160] There will be inherent differences in the supply curves determined by each RTO and ISO under the net benefits test required herein due to decisions the RTOs and ISOs must make based on supply data for their regions, the mathematical methods each RTO and ISO chooses to use for smoothing the supply curves, the certainty of changes in supply due to outages in each region, local generation heat rates, and the choice of relevant fuel price indices.

month's data from the previous year.[161] The supply curve analysis should be updated monthly, by the 15th day of the preceeding month in advance of the effective date, to allow demand response providers as well as other market participants to plan, while still reflecting current supply conditions.[162]

80. Based on historical evidence and analysis submitted in this proceeding, the threshold point along the supply stack for each month will fall in the area where the supply curve becomes inelastic, rather than the extreme steep portion at the peak or in the flat portion of the supply curve.[163] In other words, LMP will be paid to demand response resources during periods when the nature of the supply curve is such that small decreases

[161] The ISOs and RTOs are to select a representative supply curve for the study month, smooth the supply curve using numerical methods, and find the price/quantity pair above which a one megawatt reduction in quantity that is paid LMP would result in a larger percentage decrease in price than the corresponding percentage decrease in quantity (billing units). Beyond that point, a reduction in quantity everywhere along an upward sloping supply curve would be cost-effective.

[162] Thus, the test is to determine where: (Delta LMP x MWh consumed) > (LMP$_{NEW}$ x DR); where LMP$_{NEW}$ is the market clearing price after demand response (DR) is dispatched and Delta LMP is the price before DR is dispatched minus the market clearing price after DR is dispatched.

[163] Supply elasticity is defined as the percentage change in quantity supplied divided by the percentage change in price. When the elasticity is less than or equal to one, supply is considered inelastic. So, for example, in the inelastic portion of the supply curve, a reduction in quantity supplied by one percent will result in more than a one percent decrease in price. Using the terms related to demand response compensation, the billing unit effect (percentage change in quantity supplied) will be more than offset by lower LMP (percentage change in price), thus resulting in lower prices for wholesale load.

in generation being called to serve load will result in price decreases sufficient to offset the billing unit effect. The Massachusetts AG noted that the actual supply stack has locally flat and steep sections at all bid prices. We recognize that the threshold price approach we adopt here may result in instances both when demand response is not paid the LMP but would be cost-effective and when demand response is paid the LMP but is not cost-effective. We accept this result given the apparent computational difficulty of adopting a dynamic approach that incorporates the billing unit effect in the dispatch algorithms at this time.[164]

81. We direct each RTO and ISO to file its analysis as supporting documentation to the accompanying tariff revisions with the Commission on or before July 22, 2011, along with proposed tariff revisions necessary to comply with this Final Rule. The filing should include the data, analytical methods and the actual supply curves used to determine the monthly threshold prices for the last 12 months to show how the RTO or ISO would calculate the curves.[165] The Commission-approved net benefits test methodology must be posted on the RTO or ISO's website, with supporting documentation. The RTO or ISO must also post the price threshold levels that would have been in effect in the previous 12 months. In addition, when the net benefits test

[164] See supra note 114.

[165] See supra P 6.

becomes effective, the supply curve analysis for the historic month that corresponds to the effective month should be updated for current fuel prices, unit availabilities, and any other significant changes to historic supply curve and posted on the RTO website (for example, the supply curve analysis for the March price threshold would be posted in mid-February). Finally, the supply curve analyses for all months should be updated and posted on the RTO website if a significant change to the composition or slope of the historic monthly curves occurs, such as extended outages or retirements not previously reflected.

82. Some commenters argue that that there would be no need for a net benefits test if demand response resources were paid LMP-G, while others argue that use of a net benefits test otherwise undermines our decision to compensate demand response resources at the LMP. As stated above, the Commission finds that when a demand response resource participating in an organized wholesale energy market is capable of balancing supply and demand in the energy market and is cost-effective, as determined by the net benefits test described herein, that demand response resource should receive the same compensation, the LMP, as a generation resource when dispatched. We see no reason to reduce that compensation simply to avoid the use of the net benefits test that will ensure benefits to load.

83. Nearly every participant in the net benefits panel at the September 13, 2010 Technical Conference agreed that it would be counterproductive to defer to the RTO or

ISO stakeholder process to determine when demand response provides net benefits without explicit guidance from the Commission.[166] We believe that this result, and the guidance provided in this Final Rule will provide for timely improvements to RTO and ISO market pricing for demand response resources participating in organized wholesale energy markets.

84. In addition to requiring each RTO and ISO to construct the net benefits test described herein, the Commission also imposes a second requirement for each RTO and ISO to undertake a study, examining the requirements for and impacts of implementing a dynamic approach to determine when paying demand response resources LMP results in net benefits to customers. We believe that integration of the billing unit effect into RTO and ISO dispatch algorithms holds promise for more accurately integrating demand resources on a dynamic basis into the dispatch of the RTOs and ISOs. In theory, this could help ensure that the cost-effective level of demand response resources is dispatched or scheduled into the organized wholesale energy markets. Given the potential of software enhancements to determine the amount of cost-effective demand response resources purchased in the day-ahead and real- time energy markets, we believe that it

[166] "[G]etting this decision resolved is an impediment to all the other stuff we want to do with price response to demand, and DR generally in our market . . . so until we get through this, we're not going to make much progress . . . the implication of that is if you send something back that leaves a lot of room for debate, it's going to be a while on all those other things." Testimony of Robert Ethier, Vice President, Market Design, ISO-NE, Sept. 13, 2010 Tr. at 136.

would be useful for the Commission to know more about the feasibility of and requirements for implementing improvements to the existing dispatch algorithms. Therefore, we will require each RTO and ISO to undertake a study, either individually or collectively, examining the requirements for, costs of, and impacts of implementing a dynamic net benefits approach to the dispatch of demand resources that takes into account the billing unit effect in the economic dispatch in both the day-ahead and real-time energy markets, and to file the results of their study with the Commission on or before September 21, 2012.

85. ISO-NE and Pepco suggest that the net benefits test also consider the impact of demand response compensation on both energy and capacity markets. However, this Final Rule is focused only on organized wholesale energy markets, not capacity markets.[167] Given the differences in capacity markets among the ISOs and RTOs, the record in this proceeding provides neither a reasonable basis for including capacity market effects in net benefits calculations in the energy markets, nor have ISO-NE and Pepco provided a methodology for taking such effects into account. Indeed, in some

[167] Additionally, the arguments presented for focusing on the effect of demand response compensation in wholesale energy markets on capacity markets were not convincing – that decreases in energy market revenues by generators will be recouped in the form of increased capacity prices. First, they fail to consider how the increased participation by demand resources could actually increase potential suppliers in the capacity markets by reducing barriers to demand resources, which would tend to drive capacity prices down. Second, they did not examine the way in which capacity markets already may take into account energy revenues.

cases, the capacity markets already reflect energy and ancillary service revenue in determining capacity prices.

### C. Measurement and Verification

#### 1. NOPR Proposal

86. In the NOPR, the Commission explained that demand response curtailment is a reduction in actual load as compared to the demand response provider's expected level of electricity consumption.[168] The NOPR did not address measurement and verification of demand response.

87. Each RTO and ISO with a demand response program has procedures for the measurement and verification of demand response. These procedures include techniques to establish a customer baseline for each demand response participant. This customer baseline then becomes the basis for measuring the quantity of demand response delivered to the wholesale market. Customer baselines are often based on historic load information, such as an average of five of the last ten comparable days' hourly load profile. Techniques vary among RTOs and ISOs and most have several techniques that may be allowed, depending on the demand response provider's characteristics.[169]

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[168] Demand Response Compensation in Organized Wholesale Energy Markets, FERC Stats. & Regs. ¶ 32,656, at P 1 (2010).

[169] See, e.g., ISO/RTO Council, North American Wholesale Electricity Demand Response 2010 Comparison, under the tab for "Performance Evaluation Methods"

(continued…)

**2. Comments**

88. Commenters assert that the integrity of a demand response program is heavily dependent on measurement and verification.[170] Some commenters raise the issue that paying LMP in all hours presents a significant challenge to the accurate measurement and verification of demand response.[171] ISO-NE argues that when a market participant schedules demand reductions for many consecutive days, baselines may become stale—no longer reflecting a customer's "normal" electricity usage.[172] ISO-NE goes on to argue that "it is necessary to limit the number of hours or days that a demand resource could clear in the energy market so that the customer's 'normal' load can be estimated" to avoid the potential for manipulation.[173] In the context of the Commission's proposal to pay demand response the LMP in all hours, ISO-NE goes on to advocate requiring

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(http://www.isorto.org/atf/cf/%7B5b4e85c6-7eac-40a0-8dc3-003829518ebd%7D/IRC%20DR%20M&V%20STANDARDS%20IMPLEMENTATION%20COMPARISON%20(20100524).XLS).

[170] Illinois CUB May 14, 2010 Comments at 16-17; Joint Consumers May 13, 2010 Comments at 12; P3 May 12, 2010 Comments at 38; Westar May 13, 2010 Comments at 3.

[171] See, e.g., ISO-NE May 13, 2010 Comments at 32.

[172] Id.

[173] ISO-NE May 13, 2010 Comments at 34. ISO-NE identifies several practices that, in its view, might be deployed by a demand responder to receive payment when it has not, in fact, responded to price. ISO-NE states that observations of such behavior in the Fall of 2007 led it to limit the hours demand response offers could clear the market. Citing ISO New England Inc., Docket No. ER08-538-000 (February 5, 2008 filing). ISO-NE May 13, 2010 Comments at 32-34.

demand response to establish baselines by purchasing energy in the day-ahead market as a way to overcome its concerns with statistical baseline methods.[174] ISO-NE IMM makes similar arguments and recommendations.[175] Westar also appears to support this approach.[176]

89. Similarly, CPower notes that with some baseline methods, paying LMP in all hours could reward demand responders for any shift in demand from the baseline, not just shifting load from high LMP hours to low LMP hours, or could simply shift load from day-to-day in different hours to affect the calculation of actual curtailment, which it labels "checkerboarding." However, CPower believes that the capability of consumption management to shed or shift load for many hours is well into the future, and perhaps not a current concern. CPower also believes that baseline standards along with market monitoring will develop to meet these concerns.[177]

90. ISO-NE IMM asserts that "[if] the Commission adopts any proposal that permits the use of an administrative baseline it should explicitly state that any demand reductions offered into Commission-jurisdictional markets that are not genuine, even if they are the

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[174] Id.

[175] ISO-NE IMM May 13, 2010 Comments at 9-13 and Attachment A.

[176] Westar May 13, 2010 Comments at 3.

[177] CPower May 13, 2010 Comments at 4-5.

result of 'normal' activity . . . may be violations of the Commission's anti-manipulation rules and subject to penalties thereunder."[178]

91. Noting the ongoing efforts by the industry and the North American Energy Standards Board (NAESB) on measurement and verification, EnerNOC takes the view that resolution of customer baseline issues should not delay the issuance of this Final Rule.[179]

92. Finally, some commenters assert that measurement and verification methods should not be standardized, but left to the RTOs and ISOs to reflect the unique features of their individual energy, ancillary services, and capacity markets.[180]

### 3. Commission Determination

93. The Commission agrees with commenters who assert that measurement and verification are critical to the integrity and success of demand response programs. Without a determination of a demand response provider's expected use of power, the ISOs and RTOs cannot determine whether that provider has in fact reduced its energy

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[178] ISO-NE IMM May 13, 2010 Comments at 14 (footnotes omitted) (ISO-NE MMU also notes that "[i]n assessing whether demand reductions are genuine, allowance should be made for non-performance analogous to a generator's forced outage.").

[179] EnerNOC, Inc. May 13, 2010 Comments at 4.

[180] ECS May 13, 2010 Comments at 3; Indicated New York TOs May 13, 2010 Comments at 2-3; Midwest ISO May 13, 2010 Comments at 17, 21; National Grid May 13, 2010 Comments at 11-12; NSTAR May 14, 2010 Comments at 9; PPL May 13, 2010 Comments at 4.

usage when paid to do so. Towards that end, all the RTOs and ISOs already have measurement and verification protocols for their demand response programs.[181] In addition, we have adopted Phase I standards for measurement and verification published by the North American Energy Standards Board, [182] and have recognized the potential benefits of the continuing NAESB effort to craft Phase II standards with more substantive and consistent wholesale standards for measurement and verification.[183]

94. A number of commenters maintain that compensating demand response resources at the LMP during all hours could make determining baselines for demand response providers exceedingly difficult. However, the impact of our adopting the net benefits test described herein is that the LMP will not be paid to demand response resources in all hours. Accordingly, implementation of this Final Rule would not appear to prevent the determination of appropriate baselines. Nonetheless, we direct ISOs and RTOs to review their current requirements in light of the changes in this Final Rule and develop appropriate revisions and modifications, if necessary, to ensure that their baselines remain accurate and that they can verify that demand response resources have performed. Specifically, we direct each RTO and ISO to include as part of the compliance filing

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[181] See, e.g., PJM Interconnection, L.L.C., 123 FERC ¶ 61,257 (2008).

[182] Standards for Business Practices and Communication Protocols for Public Utilities, Final Rule, 131 FERC ¶ 61,022 (2010).

[183] Id., at P 32-34.

required herein, an explanation of how its measurement and verification protocols will continue to ensure that appropriate baselines are set, and that demand response will continue to be adequately measured and verified as necessary to ensure the performance of each demand response resource. If necessary, each RTO and ISO should propose any changes needed to ensure that measurement and verification of demand response will adequately capture the performance (or non-performance) of each participating demand response market participant to be consistent with the requirements of this Final Rule.

95. Finally, we agree with ISO-NE IMM that demand reductions that are not genuine may be violations of the Commission's anti-manipulation rules.[184] Allegations of such behavior will continue to be investigated, and when appropriate, sanctions will be brought to bear.

## D. Cost Allocation

### 1. NOPR Proposal

96. In response to the NOPR and September 13, 2010 Technical Conference, many commenters argue that, in order to determine the justness and reasonableness of the proposed compensation level, the corresponding cost allocation must be considered.[185]

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[184] 18 CFR 1.c (2010).

[185] ISO-NE May 13, 2010 Comments at at 39-40; see also May 13, 2010 Comments of: AEP at 6-10; CAISO at 6; ConEd at 2; Hess at 3; ICC at 12; PJM at 8; Potomac Economics at 3; Massachusetts AG at 11; Midwest ISO TOs at 5-6; Midwest TDUs at 13; EEI at 5; NECPUC at 12, 22; NECA at 11; RRI at 6; SDG&G at 3-4.

More specifically, these commenters raise concerns regarding how the costs associated with payment of LMP for demand response will be allocated, or assigned, within an ISO or RTO. Several commenters assert that the issues of cost allocation and net benefits are inherently linked, so that the Commission must address both issues together.[186]

**2. Comments**

97. Comments reveal five specific methods for cost allocation: (1) assignment of costs to the load serving entity (LSE) associated with the demand response provider, (2) assignment of costs broadly to all purchasing customers, (3) bifurcated assignment of costs with some directly assigned to a LSE and others assigned broadly, (4) directly assign the cost for demand response compensation to the retail customers that bid the demand response into the wholesale market, and (5) the settlement method proposed by CDRI, which incorporates the cost of demand response into the dispatch algorithm. Some commenters argue not for a specific method, but for each regional entity to select and employ a method of its own,[187] and a few other commenters assert that the Commission need not address cost allocation in this proceeding.[188]

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[186] As further addressed below, several commenters assert that the costs of demand response compensation should be borne by only those market participants determined to have benefitted from the subject load reduction, as determined by some type of net benefits test. See, e.g., May 13, 2010 Comments of: ISO-NE at 5-6; NECPUC at 22; PJM at 12-14; P3 at 37-38.

[187] EPSA May 12, 2010 Comments at 67; Midwest TDUs May 13, 2010 Comments at 1; ODEC May 14, 2010 Comments at 5; Potomac Economics May 14, 2010 (continued…)

98. Some commenters argue that costs should be assigned to the LSE associated with the demand response provider because it is this entity that receives the full benefit of demand response.[189] Others argue that costs should be assigned broadly to all purchasing customers because of the concept of cost causation.[190] Cost causation dictates that the costs of demand response should be allocated directly to those entities that benefit from the demand response service provided.[191] Another method presented involves a bifurcated assignment of costs, with some directly assigned to a LSE and others assigned broadly.[192] The fourth method suggested is to directly assign the costs of demand

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Comments at 9-10; RRI May 13, 2010 Comments at 4; SoCal Edison May 13, 2010 Comments at 4 (advocating that the local regulatory authority is the proper entity to regulate cost allocation); Viridity May 13, 2010 Comments at 24; EnerNOC Sept. 13, 2010 Comments at 1; Midwest TDUs Sept. 13, 2010 Comments at 2.

[188] Massachusetts AG May 13, 2010 Comments at 9-10.

[189] PJM May 13, 2010 Comments at 15; Midwest ISO May 13, 2010 Comments at 6; CAISO May 13, 2010 Comments at 6; Detroit Edison May 13, 2010 Comments at 3-4; EEI May 13, 2010 Comments at 5; NUSCO May 13, 2010 Comments at 2; National Grid Sept. 13, 2010 Comments at 2-3; Midwest ISO Oct. 13, 2010 Comments at 4.

[190] NECPUC May 13, 2010 Comments at 22; DC OPC May 13, 2010 Comments at 4; PCA Sept. 10, 2010 Comments at 4; Steel Manufactures Ass'n Sept. 13, 2010 Comments at 5; Ohio Commission Sept. 13, 2010 Comments at 4; Wal-Mart Sept. 14, 2010 Comments at 3.

[191] PJM May 13, 2010 Comments at 9; NECPUC May 13, 2010 Comments at 22; PCA Sept. 10, 2010 Comments at 4.

[192] PJM May 13, 2010 Comments at 12; ISO-NE May 13, 2010 Comments at 5.

response to the retail customer that bid the demand response into the wholesale market.[193] Lastly, the settlement algorithm proposed by CDRI adjusts upward the day-ahead price paid by the customers that participate in the day-ahead energy market to account for these costs.[194]

### 3. Commission Determination

99. When a demand response provider curtails, the RTO experiences a reduction in load with a corresponding reduction in billing units through which the RTO derives revenue. When the two conditions discussed above are met, however, the RTO must pay LMP to both generators and demand response providers for the resources that clear the energy market. The difference between the amount owed by the RTO to resources, including demand response providers, and the revenue it derives from load results in a negative balance that must be addressed through cost allocation. Therefore, a method is needed to ensure that RTOs and ISOs recover the costs of obtaining demand response.

100. Since the dispatch of demand response resources affects the LMP charged, and will result in a lower LMP, the customers benefitting from that lower LMP depends upon transmission constraints, and the price separation such constraints cause within the RTO.

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[193] DC OPC May 13, 2010 Comments at 4. It concedes that this could be a complex undertaking and would result in billing a retail customer for energy that did not consume. Id.

[194] CDRI, Integration of Demand Response Into Day Ahead Markets (Attachment B), May 13, 2010 Comments at 16.

In some hours in which transmission constraints do not exist, RTOs establish a single LMP for their entire system (a single pricing area) in which case the demand response would result in a benefit to all customers on the system. When transmission constraints are present, however, LMPs often vary by zone, or other geographic areas. Allocating the costs associated with demand response compensation proportionally to all entities that purchase from the relevant energy market in the area(s) where the demand response resource reduces the market price for energy at the time when the demand response resource is committed or dispatched will reasonably allocate the costs of demand response to those who benefit from the lower prices produced by dispatching demand response.[195]

101. We reject the various other methods of cost allocation suggested by commenters. Assignment of all costs to the LSE associated with the demand response provider, as suggested by some commenters, would not include others who benefit from the demand response. Bifurcated assignment of costs to the LSE and to others appears to represent an arbitrary division of cost responsibility without regard to the degree to which each receives benefits.

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[195] This approach is consistent with long-standing judicially-endorsed cost allocation principles. See, e.g., Midwest ISO Transmission Owners v. FERC, 373 F.3d 1361, 1368, 1370-71 (D.C. Cir. 2004); see also Illinois Commerce Comm'n v. FERC, 576 F.3d 470, 476 (7th Cir. 2009).

102. We therefore find just and reasonable the requirement that each RTO and ISO allocate the costs associated with demand response compensation proportionally to all entities that purchase from the relevant energy market in the area(s) where the demand response reduces the market price for energy at the time when the demand response resource is committed or dispatched. Accordingly, each RTO and ISO is required to make a compliance filing on or before July 21, 2011 that either demonstrates that its current cost allocation methodology appropriately allocates costs to those that benefit from the demand reduction or proposes revised tariff provisions that conform to this requirement.

### E. Commission Jurisdiction

#### 1. Comments

103. Some commenters, including several state commissions and LSEs, express concern about whether and how standardizing demand response compensation in the wholesale market will affect treatment of demand response at the retail level. They assert that the issue of demand response compensation is fundamentally intertwined with retail rates, ratepayer issues, and state jurisdictional concerns.[196] Some commenters note general concerns about the need for federal and state level coordination. They assert that

[196] See, e.g., CAISO May 13, 2010 Comments at 12; PJM May 13, 2010 Comments at 8 (appropriate and efficient demand response compensation may require coordination between the Commission, retail regulatory authorities, competitive retail suppliers, and other RTOs).

many states have taken significant steps to install advanced meters and implement programs to encourage efficient use of energy and that the success of state-level efforts should be a factor in deciding whether and how to implement demand response programs in the wholesale market.[197] According to these commenters, a Commission-mandated compensation level could have the unintended consequence of retarding the expansion of price-responsive demand at the retail level.[198]

104. Other commenters flatly question the Commission's jurisdiction to set the compensation for demand response in wholesale energy markets. They argue that it is within the purview of retail regulatory authorities to take into account local policies and concerns, and the types of demand response being offered, when determining the appropriate compensation level.[199] Indeed, the California Commission seeks clarification

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[197] See ISO-NE IMM May 13, 2010 Comments at 6.

[198] Illinois Commission May 13, 2010 Comments at 8; PJM May 13, 2010 Comments at 23; EEI May 13, 2010 Comments at 4; Capital Power May 13, 2010 Comments at 5; ODEC May 13, 2010 Comments at 60; Steel Producers May 13, 2010 Comments at 2.

[199] See Illinois Commission May 13, 2010 Comments at 13; CAISO May 13, 2010 Comments at 12-13; PJM IMM May 13, 2010 Comments at 5 ("The assertion that demand side participants should be paid full LMP, regardless of their retail tariff rate, because the current approach of paying LMP minus G represents an intervention into retail rate design, cannot be correct. The entire demand side program exists only because of the disconnect between wholesale and retail rates. The assertion that the program design should not account for the details of retail rate design leads to the conclusion that there should be no demand side program at all."); NECPUC May 13, 2010 Comments at 25 ("As energy market customers benefit most from both a well-functioning wholesale

(continued…)

that this Commission does not seek to regulate retail customer rates or seeks LSE oversight authority traditionally exercised by states. The California Commission asserts that this Commission's actions concerning CAISO's Proxy Demand Resource tariff filing[200] illustrates that demand response settlement mechanisms are within the authority of the California Commission.[201]

105. Other commenters foresee retail regulatory authorities effectively taking an end-run around any Commission-mandated compensation level by adjusting retail rate design

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market and robust participation in retail programs, a balance between these two segments is essential. Compensation that increases demand response resource participation in the wholesale market should not be so generous, from the perspective of the customer, that it makes participation in retail programs pale in comparison."); SDG&E, SoCal Edison, and PG&E May 13, 2010 Comments at 4 ("[M]andating that ISOs take on settlement responsibility or precluding any retail settlement between retail customers, LSEs or DRPs would intrude on retail jurisdictional authority and contravenes the premise of separation outlined in Order 719."); Consumers Energy May 13, 2010 Comments at 3; Detroit Edison May 13, 2010 Comments at 4.

[200] See California Independent System Operator Corp., 132 FERC ¶ 61,045 (2010).

[201] California Commission May 13, 2010 Comments at 9-10. 1. See also SDG&E, SCE, PG&E May 13, 2010 Comments at 2 ("[T]he Commission should clarify that its order does not preclude LRAs from administering retail revenue settlements between retail customers, Load Serving Entities (LSEs) and Demand Response Providers (DRPs) associated with DR participation in wholesale markets.").

or prohibiting jurisdictional end-use customers from participating in wholesale market opportunities available to demand response resources.[202] The Illinois Commission argues:

> [W]hen load serving entities are vertically integrated with generation regulated under state authority . . . any non-zero payment to a demand response resource reduces the revenues to generators under the state regulatory authority. The result is a leakage of money to an entity outside of the state's regulatory authority. Therefore, retail rates to all customers may need to be increased in order to recover the costs to generators that would have otherwise been recovered through the purchase of electricity, but instead went to the payment of a demand response resource. Therefore, compensating demand response resources may increase the likelihood that state commissions will prohibit the participation of demand response resources in the jurisdictions.[203]

106. Similarly, PJM states that the prohibition devised by retail regulatory authorities with jurisdiction over smaller distributors that deliver 4 million MWh or fewer per annum

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[202] See PJM May 13, 2010 Comments at 24; PJM May 13, 2010 Comments at 18 (It is reasonable to assume that each retail regulatory authority in PJM will re-examine the impact of load reduction based on wholesale compensation equal to the LMP, including cost allocation, on the LSEs subject to its jurisdiction, and potentially re-align retail market rules affecting economic load response participation.); Delaware Commission and NECPUC May 13, 2010 Comment at 25; OMS May 13, 2010 Comments at 7 (state commissions and LSEs have significant concerns that the potential costs for non-participating customers may exceed the benefits that ARCs can provide to their states and to participating customers, so state commissions will have a significant disincentive to support the participation of ARCs in RTO energy markets and in their states if LMP compensation is adopted).

[203] Illinois Commission May 13, 2010 Comments at 15.

may entail the revocation of previously provided permission to participate in some or all of the wholesale market opportunities for demand resources.[204]

107. Some commenters further posit that, even where retail regulatory authorities do not prohibit or limit demand response participation, they may make adjustments to the retail rate, which affect the ultimate compensation that the retail customer will be paid for its demand reductions.[205] For example, the OMS asserts,

> If the Commission were to adopt the proposed rule, state commissions and LSEs could correct this distorted price signal by revising retail tariffs for customers that do business with [aggregators of retail customers] in order to charge the retail rate to participating customers for energy which was not consumed or metered as a result of load reductions.[206]

108. Another set of commenters, especially generators, assert that due to the disconnect between wholesale and retail issues related to demand response, Commission-mandated payments for demand response will fail to address true barriers to demand response, which exist, they assert, at the retail level. These commenters argue that the Commission's actions in this proceeding ignore the fact that the primary barrier to demand response is the disconnect between retail and wholesale prices and, according to these commenters, the remedy resides at the retail -- not wholesale -- level where there is

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[204] PJM May 13, 2010 Comments at 20-21.

[205] CAISO May 13, 2010 Comments at 4.

[206] OMS May 13, 2010 Comments at 3. See also EEI May 13, 2010 Comments at 4.

a lack of dynamic pricing.[207] For example, some commenters recognize that the lack of retail real-time pricing is a barrier to demand response participation but further assert that whatever changes the Commission makes to wholesale demand response (where there is real-time pricing) will not address that fundamental problem.[208]

109. On the other hand, some commenters, such as commercial customers, wholly reject challenges to the Commission's authority to set the compensation level for demand response occurring in organized wholesale energy markets.[209] They assert that the FPA gives the Commission broad authority to correct market flaws, including compensation for demand response.[210]

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[207] Calpine May 13, 2010 Comments at 3.

[208] See EPSA May 13, 2010 Comments at 7 ("The NOPR incorrectly attempts to resolve retail market barriers to DR participation (i.e., lack of dynamic pricing) through a wholesale pricing fix."); RRI Energy May 13, 2010 Comments at 5 ("The NOPR is essentially trying to use an inefficient wholesale solution to remedy a retail problem. The NOPR does not attempt to address (nor should it attempt to address) the various retail rate structures that demand response providers in various regions of the country face."); The Brattle Group May 13, 2010 Comments at 8 ("[T]he appropriate avoidable retail generation rate is best done through agreements between the LSE and the curtailment service provider under the oversight of the relevant retail regulating authority. This approach . . . avoids requiring the RTO to sort through potentially complicated retail rate structures."); Steel Manufacturers Ass'n May 13, 2010 Comments at 9 ("[T]here is no rational basis for the Commission, or RTOs, to adopting varying demand response participation or compensation rules based on the retail pricing method of otherwise qualified participating loads.").

[209] DR Supporters Aug. 30, 2010 Reply Comments at 4.

[210] Id.

110. Some commenters further argue that any disconnect between wholesale and retail issues relevant to demand response should not negate the Commission's efforts in this proceeding. They argue that dynamic retail pricing, retail shopping opportunities and the potential for retail energy efficiency measures are no substitute for adequate wholesale demand response compensation and the deployment of demand response measures akin to a generator.[211]

111. Moreover, some commenters assert that, while the Commission has authority to establish the compensation level for demand response in the wholesale market, the Commission cannot require subtraction of retail rate components from the LMP rate, reasoning that retail rates reflect a myriad of local concerns beyond the Commission's jurisdiction. These commenters assert that LMP reflects the wholesale value of the demand response service provided and that proponents of the LMP-G formulation (subtracting a portion of the retail rate) seek to draw the Commission into a review of retail rate matters beyond its purview.[212] Additionally, these commenters point to the difficulty of isolating the generation component of the retail rate from other components, such as transmission, distribution, and overhead. They argue that different retail rate contracts reflect different costs of generation, depending on local circumstances existing

[211] Wal-Mart May 13, 2010 Comments at 11.

[212] Viridity June 18, 2010 Comments at 13.

at the time the contract was executed, and that retail rate structures reflect a wide range of competing considerations, such as cost causation, the impact of rate design on employment, and the state of the local economy, all of which are appropriately left to state commissions. These commenters posit that, instead of tailoring the wholesale rate, i.e., LMP, to retail rate conditions, it is better to get the wholesale rate right in the first instance and then allow retail rate structures adjust as needed to wholesale market conditions.[213] According to Dr. Kahn, accounting for the retail rate in this Final Rule would "ignore the proper scope of the Commission's regulatory responsibilities, the fact that the great majority of retail rate designs are economically inefficient and that it is retail rates that should not be permitted to undermine efficient wholesale rates rather than the reverse."[214]

### 2. Commission Determination

112. We begin by rejecting challenges to the Commission's authority to set the compensation level for demand response in organized wholesale energy markets. Section 205 of the FPA tasks the Commission with ensuring that all rates and charges for or "in connection with" the transmission or sale for resale of electric energy in interstate commerce, and all rules and regulations "affecting or pertaining to" such rates or charges

[213] Viridity June 18, 2010 Comments at 14.

[214] DR Supporters Aug. 30, 2010 Comments (Kahn Affidavit at 4).

are just and reasonable.[215] The Commission has previously explained that it has jurisdiction over demand response in organized wholesale energy markets, because it directly affects wholesale rates. [216]

113. For this reason, the Commission has jurisdiction to regulate the market rules under which an ISO or RTO accepts a demand response bid into a wholesale market.[217] Furthermore, as discussed above, the Commission's actions in this proceeding are consistent with Congressional policy requiring federal level facilitation of demand response, because this Final Rule is designed to remove barriers to demand response participation in the organized wholesale energy markets.

114. Nevertheless, we recognize that jurisdiction over demand response is a complex matter that lies at the confluence of state and federal jurisdiction. By issuing this Final Rule, the Commission is not requiring actions that would violate state laws or regulations. The Commission also is not regulating retail rates or usurping or impeding state regulatory efforts concerning demand response.

115. We acknowledge that many barriers to demand response participation exist and that our ability to address such barriers is limited to the confines of our statutory authority. At the same time, the FPA requires the Commission to ensure that the rates

[215] 16 U.S.C. 824d (2006).

[216] Order No. 719-A, FERC Stats. & Regs. ¶ 31,292 at P 47.

[217] Order No. 719-A, FERC Stats. & Regs. ¶ 31,292 at P 52.

charged for energy in wholesale energy markets are just, reasonable, and not unduly discriminatory or preferential. The Commission has the authority, indeed the responsibility, to assure that wholesale rates are just and reasonable. Therefore, we disagree with commenters who would have the Commission refrain from acting on demand response compensation in the organized wholesale energy markets because of the potential actions that state retail regulatory authorities may or may not take. As we note above, this Final Rule is not intended to usurp state authority or impede states from taking any actions within their authority. Rather, the Commission is taking action here to fulfill its statutory mandate to ensure just, reasonable, and not unduly discriminatory or preferential wholesale rates.

## V. Information Collection Statement

116. The Office of Management and Budget (OMB) requires that OMB approve certain information collection and data retention requirements imposed by agency rules.[218] Therefore, the Commission is submitting the proposed modifications to its information collections to OMB for review and approval in accordance with section 3507(d) of the Paperwork Reduction Act of 1995.[219]

117. OMB's regulations require approval of certain information collection requirements imposed by agency rules. Upon approval of a collection(s) of information,

[218] 5 CFR § 1320.11(b) (2010).

[219] 44 U.S.C. § 3507(d) (2006).

OMB will assign an OMB control number and an expiration date. Respondents subject to the filing requirements of a rule will not be penalized for failing to respond to these collections of information unless the collections of information display a valid OMB control number.

118. The Commission is submitting these reporting requirements to OMB for its review and approval under section 3507(d) of the Paperwork Reduction Act. Comments are solicited on the Commission's need for this information, whether the information will have practical utility, the accuracy of provided burden estimates, ways to enhance the quality, utility, and clarity of the information to be collected, and any suggested methods for minimizing the respondent's burden, including the use of automated information techniques.

Burden Estimate and Information Collection Costs: The estimated Public Reporting burden and cost for the requirements contained in the final rule follow.

| **FERC-516 Data Collection** | **Number of Respondents (a)** | **No. of Responses Per Respondent Per Year (b)** | **Hours Per Response (c)** | **Total Annual Hours (d) [a*b*c]** |
|---|---|---|---|---|
| Compliance filing, including tariff provisions and analysis (one-time filing, due 7/22/2011) | 6 (RTOs and ISOs) | 1 (one-time filing) | 300 | 1,800 (one-time filing) |
| Study on | 6 (RTOs and | 1(one-time | 2,000 | 12,000 (one- |

| | | | | |
|---|---|---|---|---|
| dynamic net benefits approach (one-time filing, due 9/21/2012) | ISOs) | filing) | | time filing) |
| Monthly update to price threshold and web posting (due monthly, starting after the compliance filing due 7/22/2011) | 6 (RTOs and ISOs) | 12 | 50 | 3,600 |

In Year 1, the following requirements are imposed[220]: (1) compliance filing due on or before July 22, 2011, and (2) monthly updates (for months 5-12, and starting after the compliance filing). The total corresponding burden hours are estimated to be: 1,800 hrs. + (8 filings * 6 respondents * 50 hrs./filing), for a total of 4,200 hours. The corresponding total cost is estimated to be: 4,200 hours * $220/hour, for a total of $924,000.

In Year 2, (a) the monthly update to the price threshold, and (b) the study on dynamic net benefits approach (due on or before September 21, 2012) are imposed. The corresponding total burden is estimated to be 3,600 + 12,000 hours, for a total of 15,600

[220] The one-time study is due on or before September 21, 2012. For the purpose of the burden and cost estimates, we are including all of the burden and cost related to the study in Year 2, although filers may perform part of the work in Year 1.

hours. The corresponding total cost estimate is: 15,600 hours * $220/hour, for a total of $3,432,000.

In Year 3, the monthly update to the price threshold is imposed. The corresponding total burden and cost are estimated to be 3,600 hours and $792,000 (3,600 hours * $220/hour).

Title: FERC-516, "Electric Rate Schedules and Tariff Filings"

Action: Proposed Collections.

OMB Control No: 1902-0096.

Respondents: Business or other for profit, and/or not for profit institutions.

Frequency of Responses: One-time filings for (a) the compliance filing, due on or before July 22, 2011, and (b) the study on dynamic net benefits approach, due on or before September 21, 2012. In addition, monthly updates to the price threshold and web posting will be required starting after the compliance filing.

Necessity of the Information: The information from FERC-516 enables the Commission to exercise its statutory obligation under sections 205 and 206 of the FPA. FPA section 205 specifies that all rates and charges, and related contracts and service conditions for wholesale sales and transmission of energy in interstate commerce be filed with the Commission and must be "just and reasonable." In addition, FPA section 206 requires the Commission, upon complaint or its own motion, to modify existing rates or services that are found to be unjust, unreasonable, unduly discriminatory or preferential.

119. In Order No. 719, the Commission emphasized the importance of demand response as a vehicle for improving the competitiveness of organized wholesale electricity markets and ensuring supplies of energy at just, reasonable and not unduly discriminatory or preferential rates. This Final Rule addresses the need for organized wholesale energy markets to provide compensation to demand response resources on a comparable basis to supply-side resources when demand response resources are comparable to supply-side resources, so that both supply and demand can meaningfully participate. This final rule establishes a specific compensation approach for demand response resources participating in organized wholesale energy markets, administered by RTOs and ISOs. Each Commission-approved RTO and ISO that has a tariff provision providing for participation of demand response resources in its organized wholesale energy market must: (a) pay demand response resources the market price (full LMP) for energy (when found to be cost-effective as determined by the net benefits test described herein), (b) submit a one-time compliance filing, (c) perform monthly updates to the Price Threshold, and (d) submit a one-time Study on Dynamic Net Benefits Approach.

120. Interested persons may obtain information on the reporting requirements by contacting: Federal Energy Regulatory Commission, 888 First Street NE, Washington, DC 20426 [Attention: Ellen Brown, Information Clearance Officer, Office of the Executive Director, e-mail: DataClearance@ferc.gov, phone: (202) 502-8663, fax: (202) 273-0873]. Comments on the requirements of the final rule may also be sent to the

Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, DC 20503 [Attention: Desk Officer for the Federal Energy Regulatory Commission]. For security reasons, comments to OMB should be submitted by e-mail to: oira_submission@omb.eop.gov. Comments submitted to OMB should include Docket Number RM10-17 and OMB Control Number 1902-0096.

## VI. Environmental Analysis

121. The Commission is required to prepare an Environmental Assessment or an Environmental Impact Statement for any action that may have a significant adverse effect on the human environment.[221] The Commission concludes that neither an Environmental Assessment nor an Environmental Impact Statement is required for this Final Rule under section 380.4(a)(15) of the Commission's regulations, which provides a categorical exemption for approval of actions under sections 205 and 206 of the FPA relating to the filing of schedules containing all rates and charges for the transmission or sale subject to the Commission's jurisdiction, plus the classification, practices, contracts, and regulations that affect rates, charges, classifications, and services.[222]

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[221] Regulations Implementing the National Environmental Policy Act, Order No. 486, 52 FR 47897 (Dec. 17, 1987), FERC Stats. & Regs., Regulations Preambles 1986-1990 ¶ 30,783 (1987).

[222] 18 CFR § 380.4(a)(15) (2010).

## VII. Regulatory Flexibility Act

122. The Regulatory Flexibility Act of 1980 (RFA)[223] generally requires a description and analysis of final rules that will have significant economic impact on a substantial number of small entities. The RFA mandates consideration of regulatory alternatives that accomplish the stated objectives of a rule and that minimize any significant economic impact on a substantial number of small entities. The Small Business Administration's (SBA) Office of Size Standards develops the numerical definition of a small business.[224] The SBA has established a size standard for electric utilities, stating that a firm is small if, including its affiliates, it is primarily engaged in the transmission, generation and/or distribution of electric energy for sale and its total electric output for the preceding twelve months did not exceed four million megawatt hours.[225] ISOs and RTOs, not small entities, are impacted directly by this rule.

123. California Independent System Operator Corp. (CAISO) is a non-profit organization with over 54,000 megawatts of capacity and over 25,000 circuit miles of power lines.

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[223] 5 U.S.C. § 601-612 (2006).

[224] 13 CFR § 121.101 (2010).

[225] 13 CFR § 121.201, Sector 22, Utilities.

124. New York Independent System Operator, Inc. (NYISO) is a non-profit organization that oversees wholesale electricity markets, dispatches over 500 generators, and manages a nearly 11,000-mile network of high-voltage lines.

125. PJM Interconnection, L.L.C. (PJM) is comprised of more than 600 members including power generators, transmission owners, electricity distributors, power marketers, and large industrial customers, serving 13 states and the District of Columbia.

126. Southwest Power Pool, Inc. (SPP) is comprised of 61 members serving over 6.2 million households in nine states and has almost 50,000 miles of transmission lines.

127. Midwest Independent Transmission System Operator, Inc. (Midwest ISO) is a non-profit organization with over 145,000 megawatts of installed generation. Midwest ISO has over 57,000 miles of transmission lines and serves 13 states and one Canadian province.

128. ISO New England, Inc. (ISO-NE) is a regional transmission organization serving six states in New England. The system is comprised of more than 8,000 miles of high-voltage transmission lines and over 350 generators.

129. The Commission believes this rule will not have a significant economic impact on a substantial number of small entities, and therefore no regulatory flexibility analysis is required.

## VIII. Document Availability

130. In addition to publishing the full text of this document in the Federal Register, the Commission provides all interested persons an opportunity to view and/or print the contents of this document via the Internet through the Commission's Home Page (http://www.ferc.gov) and in the Commission's Public Reference Room during normal business hours (8:30 a.m. to 5:00 p.m. Eastern time) at 888 First Street, NE, Room 2A, Washington DC 20426.

131. From the Commission's Home Page on the Internet, this information is available on eLibrary. The full text of this document is available on eLibrary in PDF and Microsoft Word format for viewing, printing, and/or downloading. To access this document in eLibrary, type the docket number excluding the last three digits of this document in the docket number field.

132. User assistance is available for eLibrary and the Commission's website during normal business hours from FERC Online Support at 202-502-6652 (toll free at 1-866-208-3676) or email at ferconlinesupport@ferc.gov, or the Public Reference Room at (202) 502-8371, TTY (202) 502-8659. E-mail the Public Reference Room at public.referenceroom@ferc.gov.

## IX. Effective Date and Congressional Notification

133. This Final Rule will become effective on [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]. The Commission has

determined, with the concurrence of the Administrator of the Office of Information and Regulatory Affairs, Office of Management and Budget, that this rule is not a "major rule" as defined in section 351 of the Small Business Regulatory Enforcement Fairness Act of 1996.

By the Commission. Commissioner Moeller dissenting with a separate statement attached.

( S E A L )

Kimberly D. Bose,
Secretary.

In consideration of the foregoing, the Commission proposes to amend Part 35, Chapter I, Title 18, Code of Federal Regulations, as follows.

**PART 35—FILING OF RATE SCHEDULES AND TARIFFS**

1. The authority citation for Part 35 continues to read as follows:

**Authority:** 16 U.S.C. 791a-825r, 2601-2645; 31 U.S.C. 9701; 42 U.S.C. 7101-7352.

2. Amend § 35.28 as follows:

Add a new paragraph (g)(1)(v).

**§ 35.28 Non-discriminatory open access transmission tariff.**

* * * * *

(v) Demand response compensation in energy markets. Each Commission-approved independent system operator or regional transmission organization that has a tariff provision permitting demand response resources to participate as a resource in the energy market by reducing consumption of electric energy from their expected levels in response to price signals must:

(A) pay to those demand response resources the market price for energy for these reductions when these demand response resources have the capability to balance supply and demand and when payment of the market price for energy to these resources is cost-effective as determined by a net benefits test accepted by the Commission;

(B) allocate the costs associated with demand response compensation proportionally to all entities that purchase from the relevant energy market in the area(s) where the demand response reduces the market price for energy at the time when the demand response resource is committed or dispatched.

**Note:** The following appendix will not be published in the Code of Federal Regulations.

## APPENDIX

### List of Commenters

Alcan Primary Products Corp. (Alcan)
Alcoa Inc. (Alcoa)
Alliance for Clean Energy New York, Inc. (ACENY)
Alliance to Save Energy (Alliance)
American Chemistry Council (ACC)
American Clean Skies Foundation
American Council for an Energy-Efficient Economy (ACEEE)
American Electric Power Service Corporation (AEP)
American Forest & Paper Association (AFPA)
American Municipal Power, Inc. (AMP)
American Public Power Association (APPA)
American Wind Energy Association (AWEA)
ArcelorMittal USA Inc. (ArcelorMittal)
Battelle Pacific Northwest Laboratories (Battelle)
Boston College Law School Administrative Law Class (BC Law)
California Department of Water Resources State Water Project (CDWR)
California Independent System Operator Corporation (CAISO)
California Public Utilities Commission (California Commission)
Calpine Corp. (Calpine)
Capital Power Corporation (Capital Power)
Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California (Six Cities)
Citizens for Pennsylvania's Future (PennFuture)
Coalition of Midwest Transmission Customers (CMTC)
Connecticut Municipal Electric Energy Cooperative (CMEEC)
Consert Inc. (Consert)
Conservation Law Foundation (CLF)
Consolidated Edison Solutions, Inc. (ConEd)
Constellation Energy Commodities Group, Inc. (Constellation)
Consumer Demand Response Initiative (CDRI)
Consumer Power Advocates (CPA)
Consumers Energy Company (Consumers Energy)
CPG Advisors, Inc. (CPG)
CPower, Inc. (CPower)
Crane & Co., Inc. (Crane)
Delaware Public Service Commission (Delaware Commission)

Demand Response and Smart Grid Coalition (Smart Grid Coalition)
Demand Response Supporters (DR Supporters)
Derstine's Inc. (Derstine's)
Detroit Edison Company (Detroit Edison)
Direct Energy Services, LLC (Direct Energy)
Dominion Resources Services, Inc. (Dominion)
Dr. Alfred E. Kahn (Dr. Kahn)
Dr. Charles J. Cicchetti (Dr. Cicchetti)
Dr. Roy J. Shanker (Dr. Shanker)
Dr. William W. Hogan (Dr. Hogan)
Duke Energy Corporation (Duke Energy)
Durgin and Crowell Lumber Co., Inc. (Durgin)
Edison Electric Institute (EEI)
Edison Mission Energy (Edison Mission)
Electric Power Supply Association (EPSA)
Electricity Committee
Electricity Consumers Resource Council (ELCON)
Electrodynamics, Inc. (Electrodynamics)
Energy Curtailment Specialists, Inc. (ECS)
EnergyConnect (EnergyConnect)
Energy Future Coalition (EFC)
EnerNOC, Inc. (EnerNOC)
Environmental Defense Fund (EDF)
Exelon Corporation (Exelon)
Federal Trade Commission (FTC)
FirstEnergy Service Company (FirstEnergy)
GDF SUEZ Energy North America, Inc. (GDF)
Hess Corporation (Hess)
Illinois Citizens Utility Board (Illinois CUB)
Illinois Commerce Commission (ICC)
Independent Power Producers of New York, Inc. (IPPNY)
Indicated New York Transmission Owners (Indicated New York TOs)
Industrial Energy Consumers of America (IECA)
Industrial Energy Consumers of Pennsylvania (IECPA)
Intergrys Energy Services, Inc. (Intergrys)
International Power America, Inc. (IPA)
Irving Forest Products, Inc. (Irving Forest)
ISO New England Inc. (ISO-NE)
ISO-NE Internal Market Monitor (ISO-NE IMM)
Jiminy Peak Mountain Resort, LLC

Joint Consumer Advocates (Joint Consumers)
Limington Lumber (Limington)
Madison Paper Industries (Madison Paper)
Maryland Governor Martin O'Malley (Governor O'Malley)
Maryland Public Service Commission (Maryland Commission)
Massachusetts Attorney General (Massachusetts AG)
Midwest Independent Transmission System Operator, Inc. (Midwest ISO)
Midwest ISO Transmission Owners (Midwest ISO TOs)
Midwest TDUs
Mirant Corporation (Mirant)
Monitoring Analytics, LLC (PJM IMM)
National Electrical Manufactures Association (NEMA)
National Energy Marketers Association (NEM)
National Grid USA (National Grid)
National League of Cities (NLC)
Natural Gas Supply Association (NGSA)
New England Conference of Public Utilities Commissioners (NECPUC)
New England Consumer Advocates (NECA)
New England Power Generators Association Inc. (NEPGA)
New England Power Pool Participants Committee (NEPOOL)
New England Public Systems (NE Public Systems)
New Jersey Board of Public Utilities (NJBPU)
New York Independent System Operator, Inc. (NYISO)
New York Mayor Michael R. Bloomberg (Mayor Bloomberg)
New York State Consumer Protection Board (NYSCPB)
New York State Public Service Commission (New York Commission)
North America Power Partners LLC (NAPP)
Northeast Utilities Services Company (NUSCO)
Northern California Power Agency (NCPA)
NSTAR Electric Company (NSTAR)
Occidental Chemical Corp. (Occidental)
Office of the People's Counsel for the District of Columbia (DC OPC)
Okemo Mountain Resort (Okemo)
Old Dominion Electric Cooperative (ODEC)
Organization of Midwest ISO States (OMS)
Partners HealthCare (Partners)
Pennsylvania Department of Environmental Protection (PA Department of Environment)
Pennsylvania Office of Consumer Advocate (PCA)
Pennsylvania Public Utility Commission (Pennsylvania Commission)
Pennsylvania State Representative Chris Ross (Rep. Ross)

Pepco Holdings, Inc. (PHI)
PJM Interconnection, L.L.C. (PJM)
PJM Power Providers Group (P3)
Potomac Economics, Ltd. (Potomac Economics)
PPL Parties (PPL)
Praxair, Inc. (Praxair)
Precision Lumber, Inc. (Precision)
Price Responsive Load Coalition (PRLC)
PSEG Companies (PSEG)
Public Interest Organizations (PIO)
Public Utilities Commission of Ohio (Ohio Commission)
Raritan Valley Community College (Raritan)
Robert J. Borlick (Mr. Borlick)
RRI Energy, Inc. (RRI)
San Diego Gas & Electric Company (SDG&E)
Schneider Electric USA, Inc. (Schneider)
Southern California Edison Company (SoCal Edison)
Southwest Power Pool, Inc. (SPP)
Steel Manufacturers Association (Steel Manufacturers Ass'n)
Steel Producers (SP)
Tendrill Networks, Inc. (Tendrill)
The Brattle Group
The E Cubed Company, L.L.C. (E3)
University of California, San Diego (UCSD)
Utility Economic Engineers (UEE)
Verso Paper Corp. (Verso)
Virginia Committee for Fair Utility Rates (Virginia Committee)
Viridity Energy, Inc. (Viridity)
Wal-Mart Stores, Inc. (Wal-Mart)
Waterville Valley Ski Resort Inc. (Waterville)
Westar Energy, Inc. (Westar)
Wisconsin Industrial Energy Group (WIEG)

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Demand Response Compensation in Organized Wholesale Energy Markets — Docket No. RM10-17-000

(Issued March 15, 2011)

MOELLER, Commissioner, *dissenting*:

While the merits of various methods for compensating demand response were discussed at length in the course of this rulemaking, nowhere did I review any comment or hear any testimony that questioned the benefit of having demand response resources participate in the organized wholesale energy markets. On this point, there is no debate. The fact is that demand response plays a very important role in these markets by providing significant economic, reliability, and other market-related benefits.

However, in a misguided attempt to encourage greater demand response participation in the organized energy markets, today's Rule imposes a standardized and preferential compensation scheme that conflicts both with the Commission's efforts to promote competitive markets and with its statutory mandate to ensure supplies of electric energy at just, reasonable, and not unduly discriminatory or preferential rates.[1] For these reasons, I cannot support this Rule.

## ***Standardizing Demand Response Compensation***

As an initial matter, RTOs and ISOs currently offer different types of demand response products that vary from region to region and in terms of capability and services offered in the day-ahead and real-time energy markets. Moreover, the RTOs and ISOs to date have been working with their market participants in a stakeholder process to design demand response compensation rules that are tailored to suit the needs of their individual energy markets. However, this will all change once the Rule takes effect and this existing framework is replaced with the requirement that every organized wholesale energy market pay demand resources the market price for energy (LMP) when its demand reductions are, in theory, found to be cost-effective.

[1] 16 U.S.C. § 824d (2006).

As I recognized in my initial statement in this proceeding, organized markets such as the PJM Interconnection have already demonstrated the ability to develop demand response compensation rules. Accordingly, I would have preferred to allow these markets to continue to develop their own rules. Different demand response products will have different values that reflect their varying capabilities and to require a standard payment fails to reflect these meaningful differences.[2]

However, without ever determining that the existing region-by-region approach to compensation is unjust and unreasonable, the Rule implies that the current approach is no longer adequate to ensure that rates remain just and reasonable. In turn, the Rule finds that "greater uniformity in compensating demand response resources" is required and as justification for its action, references the existence of various barriers that limit the participation of demand response in the energy markets.[3] The majority ultimately concludes that these barriers can be removed by better equipping demand response providers with the financial resources to invest in enabling technologies.[4] This is to say that the majority believes that paying demand resources more money will help overcome these barriers and encourage more participation. The Rule, however, never clearly explains how the existence of barriers, in turn, justifies a payment of full LMP to demand resources.

The Rule (like the NOPR) does not sufficiently discuss the need for standardizing compensation across the organized markets or elaborate on how standardization will remove genuine barriers that prevent meaningful participation by demand resources in the energy markets.[5] While the Energy Policy Act of 2005 states that the policy of the

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[2] California Commission May 13, 2010 Comments at 6, "[P]romulgating a uniform national rule at this time may inadvertently impede the implementation of optimal demand response compensation for an individual ISO or RTO which address the needs of that particular region." The California Commission "is concerned that mandatory 'one size fits all' pricing may stifle national and regional efforts to collect valuable data and experience regarding the effects of different demand response program designs on consumer participation and conflict with Congressional objectives."

[3] Rule at P 17, 57-59.

[4] Rule at P 57-59.

[5] Significant barriers do exist which prevent demand response from reaching its full potential. Specifically, 24 barriers were identified in our National Assessment of Demand Response Potential, FERC Staff Report, (June 2009) at 65-67.

U.S. Government is to remove unnecessary barriers to demand response, the statute never authorized the Commission to stimulate increased demand response participation by requiring its compensation to include incentives or preferential treatment.[6] Although, the majority is quick to claim "that removing barriers to demand response participation is not the same as giving preferential treatment to demand response providers…", this is exactly what is occurring in this Rule.[7] As discussed below, the majority's determination is troubling as the Rule both affords preferential treatment to demand response resources and unduly discriminates against them in other respects.

***Demand Response Resources are Comparable . . . Sometimes***

At the outset, the concept of "comparability" is at the core of this rulemaking, *i.e.*, whether demand response resources are capable of providing a service comparable to generation resources and if so, whether these resources should receive comparable compensation for a comparable service. On this point, I believe they should.[8] This is not to say that a megawatt produced is the same as a megawatt not consumed; they are not perfect equivalents. The characteristics of a megawatt and a "negawatt" are different, both in terms of physics and in economic impact.

Assuming, however, that a demand resource can provide a balancing service that is identical to that of a generation resource, it would make sense that a demand resource providing a comparable service would receive comparable compensation. But this may not occur under the Rule. The majority explains that if a demand resource is capable of providing a service comparable to a generation resource, it will only be eligible to receive comparable compensation, by definition, if it can also be determined that the resource will result in a price-lowering effect to the market by passing a net benefits test.[9]

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[6] See Energy Policy Act of 2005, Pub. L. No. 109-58, § 1252(f), 119 Stat. 594, 965 (2005).

[7] Rule at P 59.

[8] As explained below, I believe that comparable compensation is represented by the value realized by the demand resource for providing a comparable service, regardless of whether the source of that value is a payment from the market or a savings by the resource.

[9] Rule at P 47-50.

In no other circumstance is a resource required to show that its participation will depress the market price in order to receive comparable compensation for a comparable service. [10] Such a definition unduly discriminates against demand resources and as such, this requirement is unjust, unreasonable, and unduly discriminatory.

***Overcompensating Demand Resources and the Net Benefits Test***

At first glance, the Rule's requirement that RTOs and ISOs pay demand response resources the LMP only when it is deemed cost-effective appears to make sense. There is near-universal agreement that the LMP reflects the value of the marginal unit, and as such, it sends the proper price signal to keep supply and demand in relative balance. Accordingly, the Rule explains that if the demand resource is capable of providing a comparable service and is also cost-effective (*i.e.*, using a net benefits test to ensure that the overall benefit of the reduced LMP that results from dispatching demand recourses exceeds the cost of dispatching those resources), then this resource should be paid the same as a generation resource. However, the decision to pay demand resources the full LMP under such circumstances actually results in overcompensation that is economically inefficient, preferential to demand resources, and unduly discriminatory towards other market resources.

An example may help to illustrate a major flaw with this Rule. Assume that both a generation resource and a demand resource bid into the energy market and both bids are accepted and paid the LMP ($100). Then consider the fact that the demand resource will save an amount that it would have otherwise paid by not purchasing generation at the retail rate ("G"), which is $25. While the Rule requires that RTOs and ISOs pay the demand resource the LMP (which is the identical amount the generation resource receives), the Rule effectively ignores the fact that the demand resource will actually receive a total compensation of LMP+G ($125) as a result of its decision not to consume.[11] Meanwhile, the generation resource will only receive the LMP ($100)

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[10] Testimony of Audrey Zibelman, President and CEO of Viridity Energy, Inc., Sept. 13, 2010 Tr. at 119, "[T]he fact that we're debating this [net benefits test] is somewhat absurd. We have not required any other resource to demonstrate a benefit in order to enter this market."

[11] The proper economic measure of value realized by the demand resource is one where the RTO or ISO makes a reduction from the LMP to account for the retail rate, but then recognizes that the savings associated with the avoided retail generation cost should be added back into the equation, *i.e.*, (LMP-G)+G.

payment as a result of its decision to produce. While the Rule's intent is to ensure that a demand resource receives "the same compensation, the LMP, as a generation resource", this is not the actual result.[12] In this example, what will happen is that the Rule will require that the demand response resource be overcompensated by $25.[13]

The Rule effectively finds that demand resources being compensated at the *value* of full LMP is not enough, so instead requires that demand resource be *paid* the full LMP plus be allowed to retain the savings associated with its avoided retail generation cost. Professor William W. Hogan refers to this outcome as a "double-payment" because demand resources would "receive" both the cost savings from not consuming electricity at a particular price, plus an LMP payment for not consuming that same increment of electricity.[14] Not only is this result not comparable (by valuing a negawatt more than a megawatt) and economically inefficient (by distorting the price signal), but this preferential compensation will harm the efficiency of the competitive wholesale energy markets.

The use of a net benefits test further reduces competitive efficiency and only complicates the issue. As the Rule explains, the net benefits test involves the determination of a threshold price point that is plotted along a historical supply curve in an attempt to accurately calculate whether the cost of procuring additional demand response is outweighed by the value it brings to the market in the form of a lower LMP.[15]

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[12] Rule at P 82. If it were the result, the generation resource would be paid the LMP, $100, and the demand resource would be paid $75 and realize an additional $25 in retail rate savings. Accordingly, both resources realize equivalent compensation valued at $100.

[13] Ohio Commission May 13, 2010 Comments at 6, "[T]he Commission's proposal that RTOs pay demand response resources the full LMP takes the incentives for wholesale demand response resources a step too far. It would provide an incentive to the supplier of a demand response resource that exceeds the payments available to an equivalent supply resource. The Commission should instead focus on removing the existing barriers in the wholesale markets…."

[14] See Attachment to Answer of EPSA, Providing Incentives for Efficient Demand Response, Dr. William W. Hogan, October 29, 2009 (Docket No. EL09-68).

[15] Testimony of Robert Weishaar, Jr., Attorney for Demand Response Supporters, Sept. 13, 2010 Tr. at 46-47, "Administratively constructing an LMP-based break point for compensating Demand Response participation would ignore many other qualitative and

(continued…)

However, this test, which attempts to justify the LMP payment by promising a "win-win" outcome, is nothing more than a fig leaf that provides little protection against the long-term potential for unintended market damage. As recognized by ISO-NE, generation is not dispatched and paid for only when such generation reduces LMP, instead generation is dispatched and paid for only when it is cost-effective.[16] Likewise, logic would require that demand resources be treated similar to generation resources and be similarly cost-effective.

During a technical conference convened to discuss the specific question on the necessity of a net benefits test, the Commission heard testimony from a panel of experts. A clear majority of the witnesses (representing a spectrum of interests that included demand response advocates, economists, generators, and the RTOs and ISOs) argued against the use of a complicated and admittedly imprecise[17] net benefits test.[18] Chief among their concerns was that a net benefits test is unnecessary since the market clearing function in a wholesale market, by definition, serves to guarantee that the resource that clears the market is the lowest-cost resource.[19] Other experts commented that the net benefits test would be complicated, costly to implement, and of little value.[20] Notably, Dr. Alfred E. Kahn, the majority's oft-quoted expert in defense of the full LMP payment, did not opine on the merit of subjecting the LMP payment to a net benefits test.

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quantitative benefits of Demand Response. Focusing only on the LMP impacts of Demand Response is problematic."

[16] ISO-NE May 13, 2010 Comments at 3-4.

[17] Rule at P 80. Recognizing that "the threshold price approach we adopt here may result in instances both when demand response is not paid the LMP but would be cost-effective and when demand response is paid the LMP but is not cost-effective."

[18] Testimony of Donald Sipe, Attorney for Consumer Demand Response Initiative, Sept. 13, 2010 Tr. at 43, "[T]here is probably not a need for a Net Benefits Test. But if one is adopted, it should not be an artificial threshold that can be wrong both ways. It should not be a mechanism that treats DR differently than generation."

[19] Viridity Energy, Inc., Oct. 13, 2010 Comments at 10. See also ELCON Oct. 13, 2010 Comments at 3; and Environmental Defense Fund Comments at 2.

[20] Testimony of Andy Ott, Sr. Vice President, PJM Interconnection, Sept. 13, 2010 Tr. at 19, "[Y]ou have to use caution to actually take a benefits test and apply that to compensation, because you may have unintended consequences."

Further, as explained by Dr. Roy J. Shanker, if the Commission adopted the payment of LMP minus the retail rate ("G"), then there is no need for a net benefits test since the customer is paid the difference between the LMP and what they would have paid under their retail rate, which is their net benefit. [21] He testified that the "Net Benefits criteria is troubling in and of itself, as it explicitly incorporates consideration of portfolio effects caused by the reduced demand on all load payments, versus the economic decision-making of individual market participants pursuing their own legitimate business purpose."[22]

I similarly agree that this test is unnecessary and will only distort price signals by attracting more demand response than is economically efficient.[23] The use of a net benefits test also is troubling in that the Commission's decision can be viewed as somehow equating the concept of a just and reasonable rate with a lower price.[24] However, I recognize that to defend its compensation scheme, the majority needed some proposal that could arguably demonstrate that the cost of paying full LMP to demand resources would be outweighed by the "benefit" of a lower market price.[25] The net benefits test serves this unenviable role.

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[21] Testimony of Roy J. Shanker, Ph.D, PJM Power Providers Group, Sept. 13, 2010 Tr. at 60, "If the Commission adopts the appropriate non-discriminatory pricing for Demand Response, and payment of LMP minus the retail rate in the context of customer that face a fixed retail rate, then there is no need for a Net Benefits test."

[22] Id., Tr. at 61.

[23] EPSA May 13, 2010 Comments at 23. See also May 13, 2010 Comments of APPA at 13; FTC at 9; Midwest TDUs at 14; Mirant at 2; New York Commission at 5; PJM at 6; PSEG at 5; and Potomac Economics at 6-8.

[24] Courts have stated that to be "just and reasonable," rates must fall within a "zone of reasonableness" where they are neither "less than compensatory" to producers nor "excessive" to consumers. Farmers Union Central Exchange v. FERC, 734 F.2d 1486 (D.C. Cir. 1984), cert denied, 469 U.S. 1034 (1984). See also EPSA May 13, 2010 Comments at 19; and ISO-NE at 26-28.

[25] Testimony of Ohio Commissioner Paul Centolella, Sept. 13, 2010 Tr. at 141, "The Net Benefits test reflects a recognition that paying full LMP may over-compensate Demand Response and increase cost to customers."

***Relationship to State Retail Regulation***

The Rule recognizes that the demand resource will retain the retail rate ("G") as part of the provider's total compensation, but declines to account for this savings citing "practical difficulties" for state commissions, RTOs and ISOs.[26] While the authority over retail rates is properly within the jurisdiction of the state commissions, under the LMP-G equation, the RTO/ISO merely subtracts the retail rate; it does not interfere with the retail rate in any way.[27] Although the Rule refers to the New York Commission's position that subtracting the retail rate would be an "administrative burden" or create "undue confusion"[28], other state commissions disagree and contend that the retail rate can be deducted without any concern about impacting the states' retail jurisdiction.[29]

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[26] Rule at P 63. The RTOs and ISOs uniformly state that compensation which ignores the retail rate will yield uneconomic outcomes and overcompensate the demand resource. Moreover, none of the RTOs or ISOs claimed it would be difficult to subtract the retail rate from the LMP payment. See May 13, 2010 Comments of CAISO at 5-6; ISO-NE at 17-26; Midwest ISO at 6-11; NYISO at 12-16; and PJM at 5-16.

[27] Testimony of Joel Newton, New England Power Generators Ass'n, Sept. 13, 2010 Tr. at 75; "The Commission is getting into a real close area with retail ratemaking as we go through this entire process. For the Commission then to say 'ignore the LSE payment' which is the realm of state commissions, it's almost as you're just hoping that the state commissions will go out and fix it. The state commissions can do that…[b]ut the proper thing to do now is to get the price right at the outset." See also Testimony of Ohio Commissioner Paul Centolella, Sept. 13, 2010 Tr. at 197; "[FERC is] putting the state in the position where if we were to try to get back to an efficient level of incentives, we would be having to in effect issue a charge for energy that was not consumed. We would be doing what would be perceived as a take-back by that customer. And that would put us in a very difficult position."

[28] Rule at P 28. Significantly, the New York Commission "acknowledges the overstated price signal inherent in an LMP-based formula for DR compensation…." "Although we understand that *an LMP demand response compensation formula may result in uneconomic demand response decisions in the markets (i.e., a price signal that exceeds marginal cost)*, it also creates an incentive to participate in DR programs…." New York Commission May 13, 2010 Comments at 5-6 (emphasis added).

[29] Illinois Commission May 13, 2010 Comments at 13, "[I]f tariffs are well designed, controversy over the jurisdictional issue can be avoided. Requiring an ex ante approval of the retail rate to be subtracted from the LMP at the time demand response resources are utilized …accomplishes this design." See also Indiana Commission

(continued…)

Moreover, the Rule does not conclude that LMP-G would interfere with the retail jurisdiction of the states, but goes as far as to acknowledge the subtraction of G is "perhaps feasible."[30] The fact is that this calculation is quite feasible. Markets such as the PJM Interconnection currently subtract the retail rate portion from the LMP payment and there is no evidence that accounting for the retail rate by making the necessary reduction is either burdensome or interferes with the retail jurisdiction of state commissions.[31]

***The Unintended Consequences of Paying Too Much***

Today's determination, unencumbered by "textbook economic analysis of the markets subject to our jurisdiction" will undoubtedly have effects, both in the short-term and the long-term.[32] The intended consequence of providing additional compensation to demand resources is that demand response participation will increase in the energy markets. In turn, this additional demand response participation will have the effect of lowering the market price. However, it is at this point where the unintended effects will begin to appear.

With a reduced LMP, the price signal sent to customers will be that the cost of power is cheaper so they may decide to use more power even though the real cost of producing that power is now higher. Such a result turns the concept of scarcity pricing on its head and results in an economically inefficient outcome. Conversely, customers who are demand response providers now stand to receive more than the market price as an incentive to curtail their consumption and will begin to make inefficient decisions about using power.[33] Such inefficiencies will result in customers experiencing a short-

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September 16, 2009 Comments at 3 (Docket No. EL09-68), "LMP-G is an accepted indicator of cost-effectiveness. Therefore, to provide incentive compensation at a level that is above the LMP raises the specter of unjust and unreasonable rates."

[30] Rule at P 63.

[31] See Sections 3.3A.4 and 3.3A.5 (Market Settlements in the Real-Time and Day-Ahead Energy Markets) of the Appendix to Attachment K of the PJM Tariff.

[32] Rule at P 46.

[33] Federal Trade Commission May 13, 2010 Comments at 6, "If customers have to pay the retail price for power they use but pay nothing for power they resell, then they will have incentives to resell power in situations in which it would be more beneficial for

(continued…)

term benefit by way of a lower LMP, but will also impose long-term costs on the energy markets.[34]

The long-term costs of allowing demand resources to receive preferential compensation will manifest themselves in various ways. As noted in my initial statement in this proceeding, the lack of dynamic prices at the retail level is the primary barrier to demand response participation. This Rule does not remedy this barrier and customers who pay fixed retail rates will not benefit from lower wholesale market prices. Meanwhile, at the wholesale level, the corrosive effect of overcompensating demand resources over time will come at the expense of other resources, particularly generation resources that will have less to invest in maintaining existing facilities and financing new facilities.[35]

The Commission's recent progress in promoting competitive wholesale energy markets has the potential to be undone as a result of this well-meaning, but misguided Rule. I believe in the proven value of market solutions and therefore agree with the majority's statement that "while the level of compensation provided to each resource affects its willingness and ability to participate in the market, ultimately the markets themselves will determine the level of generation and demand response resources needed

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society for them to consume it." See also EPSA May 13, 2010 Comments at 23; APPA at 13; FTC at 9; Midwest TDUs at 14; Mirant at 2; New York Commission at 5; PJM at 6; PSEG at 5; and Potomac Economics at 6-8.

[34] PJM's Independent Market Monitor (a/k/a Monitoring Analytics, LLC) Oct. 16, 2009 Comments at 7-8 (Docket No. EL09-68), "Demand side resources are not generation. In a well functioning market, demand-side resources avoid paying the market price of energy when they choose not to consume. This allows customers to make efficient decisions about using power. It also follows that a customer receiving more than the market price as an incentive to curtail will make inefficient decisions about using power, and that this inefficiency imposes a cost rather than providing a benefit to society."

[35] NYISO May 13, 2010 Comments at 15, "[P]aying demand response an LMP-based payment because it is thought that demand response participation will reduce LMPs for all customers is not a sufficient rationale for justifying an 'additional payment' for a favored technology. Demand response is not the only resource able to provide such benefits. However, [other] technologies may be kept out of the market by demand response that would be uneconomic at LMP-G but participates when subsidized at LMP."

for purposes of balancing the electricity grid."[36] That's precisely how markets should work. Price signals will attract resources and new investment when prices are high, and perhaps not so much when prices are low.[37] If the playing field is level, resources can compete to the best of their abilities and efficient, cost-effective market outcomes will result.

As noted earlier, I would have preferred that we allow the regional markets to continue to develop their own compensation proposals. However, I also recognize that returning to a pre-NOPR era would be difficult now that the Commission has signaled a new policy of standardized compensation. Accordingly, if I were to now support any standardization of demand response compensation, it would be the LMP-G approach, which in my opinion, is the only economically efficient outcome for the markets.

Ultimately, the Rule, by requiring demand resources to artificially suppress the market price in order to receive incomparable compensation, will negatively impact the long-term competitiveness of the organized wholesale energy markets.[38] As such, lacking sufficient rationale, I cannot support this Rule as it violates the Commission's statutory mandate to ensure supplies of electric energy at just, reasonable, and not unduly discriminatory or preferential rates.

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Philip D. Moeller
Commissioner

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[36] Rule at P 59.

[37] PJM Interconnection's experience with paying LMP-G for demand response in its energy market provides an example of how market fundamentals properly influence demand resource participation. PJM's Independent Market Monitor recently reported that "[p]articipation levels through calendar year 2009 and through the first three months of 2010 were generally lower compared to prior years due to a number of factors, including lower price levels, lower load levels, and improved measurement and verification, but *have showed strong growth through the summer period as price levels and load levels have increased*. Citing Monitoring Analytics, LLC, 2010 State of the Market Report for PJM at 30 (March 10, 2011) (emphasis added).

[38] Federal Power Act § 205(a), 16 U.S.C. § 824d (2006), "[A]ll rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful."

**TAB D**

*Quizno's Canada Restaurant Corp v. 1450987 Ontario Corp.,*
*2009 CarswellOnt 2280 (Ont Sup Ct J)*

2009 CarswellOnt 2280, [2009] O.J. No. 1743, 176 A.C.W.S. (3d) 1016

**Most Negative Treatment:** Distinguished
**Most Recent Distinguished:** MTY TIKI MING Enterprises v. Boundris | 2016 ONSC 3290, 2016 CarswellOnt 9445, 267 A.C.W.S. (3d) 930 | (Ont. S.C.J., May 27, 2016)

2009 CarswellOnt 2280
Ontario Superior Court of Justice

Quizno's Canada Restaurant Corp. v. 1450987 Ontario Corp.

2009 CarswellOnt 2280, [2009] O.J. No. 1743, 176 A.C.W.S. (3d) 1016

# QUIZNO'S CANADA RESTAURANT CORPORATION and QUIZNO'S CANADA REAL ESTATE CORPORATION (Plaintiffs) and 1450987 ONTARIO CORP., 2036249 ONTARIO INC., 2036250 ONTARIO INC., THOMAS JOHNSON and DOUGLAS JOHNSON (Defendants)

Perell J.

Heard: April 20-22, 2009
Judgment: April 28, 2009
Docket: CV-09-7997-00CL

Proceedings: refused leave to appeal *Quizno's Canada Restaurant Corp. v. 1450987 Ontario Corp.* (2009), 2009 CarswellOnt 3455 (Ont. Div. Ct.)

Counsel: Geoffrey B. Shaw, Eunice Machado, Timothy Pinos for Plaintiffs
David Sterns, Sam Hall for Defendants

Subject: Contracts; Civil Practice and Procedure

**Related Abridgment Classifications**

Civil practice and procedure
XIV Practice on interlocutory motions and applications
XIV.4 Notice of motion or application
XIV.4.a Service
XIV.4.a.i Time for

Contracts
XVI Franchising contracts
XVI.5 Performance or breach
XVI.5.c Duty of franchisees
XVI.5.c.ii Operation in accordance with franchise agreement

Remedies
II Injunctions
II.2 Prohibitive injunctions
II.2.c Interim and interlocutory injunctions
II.2.c.i Threshold test
II.2.c.i.D Miscellaneous

2009 CarswellOnt 2280, [2009] O.J. No. 1743, 176 A.C.W.S. (3d) 1016

**Headnote**

Contracts --- Franchising contracts — Performance or breach — Duty of franchisees — Operation in accordance with franchise agreement

Franchisor operated chain of fast food restaurants — Over year and half period, franchisor sent three franchisees notices of default with respect to allegations of selling under-proportioned sandwiches to customers, failing to participate in promotions, and failing to provide delivery service as directed by franchisor — Franchisor ultimately terminated franchise agreements and brought action for breach of franchise agreements — Upon motion for interim order, court ordered that independent observer be present for further inspections by franchisor — Franchisor brought motion for injunction to restrain three franchisees and their owners from operating similar restaurant business within eight-kilometre radius of franchisees' current locations — Franchisees brought counter-motion seeking order to restrain franchisor from disrupting status quo pending trial and to continue terms of existing interim interlocutory order — Franchisor's motion granted; franchisees' counter-motion dismissed — Franchisor showed serious issue that franchisees breached franchise agreements by under-proportioning sandwiches — Franchisees conceded that they did not fully comply with several promotions, and they did not implement delivery program — Promotions and delivery program were mandated for all franchisees — Express contract language that supported franchisor's position with respect to delivery program and there was reasonably strong argument that existing language of franchise agreement required franchisee to comply with standards and specifications of promotions as set by franchisor — Franchisor would suffer irreparable harm if interlocutory injunction was not granted — Franchisees would not be able to satisfy damages award against them and irreparable harm suffered by franchisor goes to its goodwill, its reputation, and its responsibility to franchisees of chain to maintain integrity of franchise system — Damages would not adequately address these harms — Franchisees showed serious issue to be tried, and that it would suffer irreparable harm unless they were granted interlocutory injunction, but failed balance of convenience test — If interlocutory injunction was granted and franchisor failed, award of damages would provide worthwhile remedy for wrongful termination of franchise agreements — Given matters at stake, strength of comparative cases and ineffectiveness of damage award at trial should franchisor succeed, balance of convenience favoured granting franchisor interlocutory injunction.

Civil practice and procedure --- Practice on interlocutory motions and applications — Notice of motion or application — Service — Time for

Franchisor operated chain of fast food restaurants — Over year and half period, franchisor sent three franchisees notices of default with respect to allegations of selling under-proportioned sandwiches to customers, failing to participate in promotions, and failing to provide delivery service as directed by franchisor — Franchisor ultimately terminated franchise agreements and brought action for breach of franchise agreements — Upon motion for interim order, court ordered that independent observer be present for further inspections by franchisor — Franchisor brought motion for injunction to restrain three franchisees and their owners from operating similar restaurant business within eight-kilometre radius of franchisees' current locations — Franchisees brought counter-motion seeking order to restrain franchisor from disrupting status quo pending trial and to continue terms of existing interim interlocutory order — Franchisor's motion granted; franchisees' counter-motion dismissed — Notwithstanding its late delivery, court accepted delivery of franchisees' notice of motion — There was no substantial prejudice to franchisor in proceeding this way — Franchisor always anticipated that there would be counter-motion — Issues of anticipated counter-motion largely mirrored issues of franchisor's motion, and given that there was no additional factual material filed in support of counter-motion, it was unlikely that franchisor was prejudiced in any meaningful way by late arrival of anticipated motion — Parties were better served if court was able to make order that comprehensively determined all competing claims for interlocutory relief that could and should have been made by parties when franchisor put its rights before court — Both parties had their days in court, and it made little sense to make order on franchisor's motion that left uncertain how franchisees' counter-motion should be determined.

Remedies --- Injunctions — Availability of injunctions — Prohibitive injunctions — Interim and interlocutory injunctions — Threshold test — Miscellaneous

Franchisor operated chain of fast food restaurants — Over year and half period, franchisor sent three franchisees notices of default with respect to allegations of selling under-proportioned sandwiches to customers, failing to participate in promotions, and failing to provide delivery service as directed by franchisor — Franchisor ultimately terminated franchise agreements and brought action for breach of franchise agreements — Upon motion for interim order, court ordered that independent observer be present for further inspections by franchisor — Franchisor brought motion for injunction to restrain three franchisees and their owners from operating similar restaurant business within eight-kilometre radius of franchisees' current locations — Franchisees brought counter-motion seeking order to restrain franchisor from disrupting status quo pending trial and to continue terms of existing interim interlocutory order — Franchisor's motion granted; franchisees'

 

counter-motion dismissed — Franchisor satisfied test for interlocutory injunction — Franchisor showed serious issue that franchisor breached franchise agreements by under-proportioning sandwiches — Franchisees conceded that they did not fully comply with several promotions, and they did not implement delivery program — Promotions and delivery program were mandated for all franchisees — Express contract language that supported franchisor's position with respect to delivery program and there was reasonably strong argument that existing language of franchise agreement required franchisee to comply with standards and specifications of promotions as set by franchisor — Franchisor would suffer irreparable harm if interlocutory injunction was not granted — Franchisees would not be able to satisfy damages award against them and irreparable harm suffered by franchisor goes to its goodwill, its reputation, and its responsibility to franchisees of chain to maintain integrity of franchise system — Damages would not adequately address these harms — Franchisees showed serious issue to be tried, and that it would suffer irreparable harm unless they were granted interlocutory injunction, but failed balance of convenience test — If interlocutory injunction was granted and franchisor failed, award of damages would provide worthwhile remedy for wrongful termination of franchise agreements — Given matters at stake and strength of comparative cases and ineffectiveness of damage award at trial should franchisor succeed, balance of convenience favoured granting franchisor interlocutory injunction.

**Table of Authorities**

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*Benjamin v. Toronto Dominion Bank* (2006), 2006 CarswellOnt 1887, 23 E.T.R. (3d) 149, 80 O.R. (3d) 424 (Ont. S.C.J.) — referred to

*Boehmer Box L.P. v. Ellis Packaging Ltd.* (2007), 2007 CarswellOnt 2726, 2007 C.L.L.C. 210-025 (Ont. S.C.J.) — referred to

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*1323257 Ontario Ltd. v. Hyundai Auto Canada Corp.* (2009), 2009 CarswellOnt 88 (Ont. S.C.J.) — referred to

*2038724 Ontario Ltd. v. Quizno's Canada Restaurant Corp.* (2008), 2008 CarswellOnt 1156, 89 O.R. (3d) 252, 56 C.P.C. (6th) 88 (Ont. S.C.J.) — referred to

**Statutes considered:**

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Generally — referred to

s. 3 — considered

*Competition Act*, R.S.C. 1985, c. C-34
s. 61 — referred to

**Rules considered:**

*Rules of Civil Procedure*, R.R.O. 1990, Reg. 194
R. 14 — referred to

MOTION by franchisor for interlocutory injunction closing three franchises and restraining franchisees and owners from operating similar business; COUNTER-MOTION by franchisees for interlocutory injunction to restrain franchisor from disrupting status quo pending trial and to continue terms of existing interim interlocutory order.

***Perell J.*:**

**Introduction and Overview**

1 This is a breach of contract action between a restaurant franchisor and three of its franchisees. As a background factual matter, the relevance of which is disputed, this contract action has been connected to a class action in which one of the franchisees has been nominated as the representative plaintiff. In that action, it is alleged that the franchisor has conspired to overprice supplies to all its franchisees. As it happens, in March 2008, I dismissed the motion for certification. (See *2038724 Ontario Ltd. v. Quizno's Canada Restaurant Corp.*, [2008] O.J. No. 833 (Ont. S.C.J.).) My judgment, however, was appealed, the appeal was argued in November 2008, and the judgment of the Divisional Court was released on April 27, 2009. With a dissenting judgment, the court granted the appeal and conditionally certified the class action. I will return to the matter of the connection of the contract action with the class action.

2 In the contract action, the franchisor, and a co-plaintiff, is Quizno's Canada Restaurant Corporation ("Quizno's Canada"), which oversees a chain of fast food restaurants across Canada that sell toasted submarine sandwiches. There are around 450 Quiznos restaurants in Canada and the parent corporation oversees a considerably larger number of Quiznos restaurants in the United States. Related to the Canadian franchisor is the co-plaintiff, Quizno's Canada Real Estate

  

Corporation. This corporation leases properties for Quiznos restaurants, and it is the landlord for one of the three defendant franchisees in the contract action.

3 The co-owners of the three franchises are the defendants, Mr. Douglas Johnson and his nephew, Mr. Thomas Johnson. The three franchisees joined as defendants are: (1) 1450987 Ontario Corp. ("the Dundas St. Restaurant," sometimes referred to as the Trafalgar Restaurant); (2) 2036249 Ontario Inc. ("the Third Line Restaurant"); and (3) 2036250 Ontario Inc. ("the Cornwall Rd. Restaurant"). The Johnsons are guarantors under the franchise agreements.

4 The Dundas Street and Cornwall Rd. Restaurants have carried on business as Quiznos restaurants since April 2001. The Third Line Restaurant has been a Quiznos franchisee since March 2003. The Cornwall Rd. Restaurant is one of the proposed representative plaintiffs in the class action, which has been brought on behalf of all the Canadian Quiznos franchisees.

5 In the breach of contract action, Quizno's Canada, amongst other things, asks the court to help it close down three fast-food restaurants and to restrain the three franchisees and their owners from operating a similar restaurant business within an eight-kilometer radius of the franchisees' current locations in Oakville, Ontario.

6 By way of their response to the franchisor's motion - but without having delivered a counter-motion until the last minutes of three days of hearings - the franchisees seek an order that would restrain Quizno's Canada from disrupting the *status quo* pending the trial and that would continue the terms of an existing interim interlocutory order.

7 I shall have more to say about the franchisees' request for substantive relief by way of a defence to a motion but foreshadow to say that this approach yielded rhetorical fireworks during the argument of the motion not to mention a due process problem.

8 When, during the argument, the three franchisees appreciated - apparently for the first time - that their aspiration for an order maintaining the *status quo* might be stillborn, they offered to deliver a notice of motion without any supporting material other than the record before the court. The franchisor objected, but the late arriving notice of motion arrived, and thus, I must solve this added problem of determining what requests for relief are properly before the court.

9 For its part, Quizno's Canada has no procedural problems in making its request for interlocutory relief. In support of its motion breach, Quizno's Canada submits that in the past 12 months, the three franchisees have breached their respective franchise agreements. During this time, three main types of breaches are alleged: (1) selling under-portioned sandwiches to customers; (2) failing to participate in promotions; and (3) failing to provide the delivery service as directed by Quizno's Canada.

10 Quizno's Canada also alleges other breaches of the franchise agreements. It submits that given the breaches, it was within its rights to terminate the franchise agreements and to call on the franchisees to comply with their post-termination obligations as set out in the franchise agreements. In terminating the franchises, Quizno's Canada also relies on what was described as the "three strikes rule" in the franchise agreements (section 18.2 (k)).

11 All the breaches are and have been denied by the three franchisees, but, nevertheless, Quizno's Canada served several notices of default, and on February 4, 2009, it purported to terminate the three franchises because of the alleged defaults.

12 The three franchisees deny the validity and *bona fides* of the notices of default and of the terminations and submit that Quizno's Canada is using the terminations: to retaliate against the Johnsons for standing up against the franchisor; to coerce other franchisees to abandon the association known as Denver Subs Canadian Franchisee Association ("Denver Subs"), which is led by Mr. Douglas Johnson; to threaten and intimidate the class members in the class proceeding; and to coerce the franchisees to accept a settlement proposed by Quizno's Canada.

13 The three franchisees submit that Quizno's Canada and its American parent corporation have a history of using harsh, retaliatory, and punitive tactics to silence and isolate franchisees that Quiznos regards as defiant. The three franchisees also submit that, they are not defiant but rather compliant - but not servile - franchisees who are just exercising their rights under their franchise agreements in a proper and respectful manner.

  

14 For the obvious reason that they deny default and for other reasons connected to the alleged intimidation tactics, the three franchisees have refused to comply with the post-termination provisions of the franchise agreements. Under the franchise agreements (section 18.7), upon termination, a franchisee must, among other things, cease to identity itself as a Quiznos franchise or use any marks, trade secrets, signs, symbols, devices, trade names, or other materials of Quiznos. Upon termination, it must return Quizno's operations manual and other proprietary material. After termination, the franchisee promises (section 20.3) not to compete within a defined eight-kilometer radius for two-years.

15 When the three franchisees refused to accept the termination of their franchises, Quizno's Canada and Quizno's Real Estate sued the franchisees. Quizno's Canada delivered a statement of claim and brought the interlocutory motion now before the court to close down the restaurants and to enforce the post-termination obligations contained in the franchise agreements. Quizno's Canada has given the usual undertaking as to damages with respect to injunctive relief. In anticipation of a counter-motion - which did not arrive until the end of the argument - Quizno's Canada voluntarily and on a without prejudice basis indicated that it would not take any enforcement steps pending a court order.

16 The franchisees delivered a statement of defence and counterclaim. The original counterclaim claims damages, but the counterclaim did not include a claim for injunctive relief until the franchisees delivered an amended statement of claim and counterclaim after the argument of the motion.

17 In moving for an interlocutory injunction, Quizno's Canada submits that its franchise system and its brand will suffer irreparable harm and the entire purpose and integrity of its business would be undermined if the three franchisees continue to operate a submarine restaurant at their current locations. Quiznos submits that the balance of convenience favours the granting of an injunction since the three franchisees can compete outside of the territory delimited by the non-competition clause.

18 Quizno's Canada submits that the continued operation of a terminated franchise would harm Quiznos because it would mean that it has lost control of its goodwill and of its franchise network. Further, it would prevent Quiznos from servicing the market that is being serviced by the unauthorized franchisees.

19 Mr. Macdonald, who is President of Quizno's Canada, deposes at paragraph 113 of his affidavit sworn on February 5, 2009:

> If the Franchisees are permitted to operate competing restaurants in the same premises as their Quiznos Sub restaurants despite their termination of the Franchise Agreements, there will be less incentive for Quiznos' other franchisees to abide by their agreements. The message will be sent through Quiznos' system that Quiznos' franchise agreement (i) provide no protection to other franchisees, and (ii) may be disregarded at will. This will have a detrimental and devastating effect throughout the Quiznos franchise system. It has the potential to effect the demise of the system in Canada as Quiznos depends on renewals and the enforcement of its non-competition covenants to maintain its vitality. In particular, there are eight other Quiznos' franchisees in the GTA who have, to date, refused to offer delivery services. They will no doubt continue to breach the terms of their franchise agreements should this court not grant the injunctive relief sought.

20 As already noted, before moving for an interlocutory injunction, Quizno's Canada did not exercise its self-help remedies in anticipation of a counter-motion by the franchisees. When before the argument of the motion, that counter-motion did not come, in its factum and during argument, Quizno's Canada took the positions that this circumstance supported their claim for injunctive relief and also precluded the court from making an order that would maintain the *status quo* or interfere with the franchisor's rights to exercise self-help in the event that injunctive relief was refused. It was the verbalization of these positions that galvanized the franchisees to deliver their counter-motion and their amended statement of defence and counterclaim.

21 Either by way of a defence to the franchisor's motion or now by their counter-motion, the franchisees submit that the court should dismiss Quizno's Canada's motion for interlocutory relief and instead the court should make an order preserving the *status quo* pending the trial of the action and of the franchisees' counterclaim.

22 The franchisees submit that they will suffer irreparable harm if the *status quo* is not maintained. Mr. Douglas Johnson

  

states at paragraph 144 of his March 3, 2009 affidavit:

> I am struck by the statement of the President of my franchisor [Mr. Macdonald] that the loss of my stores on which I depend for my livelihood, however meager it may be, is of little consequence. I have no occupation other than my employment as owner/operator of my stores. I draw from the stores a wage sufficient to support myself, my wife who is eight months pregnant, and our two-year old baby. Tom also depends entirely on the restaurant for his subsistence. As independent business owners, we do not pay into unemployment insurance and would receive no benefits if we lost our stores.

23 The franchisees also submit that the other Canadian franchisees will suffer irreparable harm because they will lose their champion in the ongoing struggle for redress against the franchisor if the defendant franchisees are removed from the franchise system. In paragraph 167 of their factum, they state:

> 167. Uniquely to this motion, other franchisees within the Quiznos system would be irreparably harmed by the termination of the Johnsons' stores and loss of their leadership. Should the certification decision be reversed on appeal, the termination of the Johnsons' stores prior to the opt-out period will cause irreparable harm to all franchisees who have banded together in the Class Action to obtain justice despite Quiznos' tactics and intimidation. This harm cannot be quantified in monetary terms.

24 At the conclusion of the hearing of the motion, I made the following endorsement:

> This is a motion for interlocutory relief brought by Quiznos. I am reserving judgment with respect to this motion. There is also before me a motion delivered today by the defendants. I am reserving judgment on whether the court will receive this motion and on whether or not it should be decided on its merits. In the interim, the interim interlocutory order that I granted on February 18, 2009 is to continue pending further order of the court.

25 Now having considered the matter and for the reasons that follow, I have decided to receive the franchisees' counter-motion and to dismiss it on its merits. I dissolve the interim interlocutory injunction and I grant Quizno's Canada's motion as requested.

26 To explain these conclusions, I will first address the matter of the counter-motion. Second, I will discuss the general principles of the law associated with requests for interlocutory injunctions that I will be applying in the circumstances of the case at bar. Third, I will describe the factual background and foreground to the case at bar. Fourth, I will apply the law associated with requests for interlocutory injunctions in the context of the competing factual and legal arguments of the parties and explain why I dismiss the franchisees' motion and grant the motion of the franchisor. Fifth, and finally, I will have a concluding comment about how others might avoid the unhappy outcome that has been visited on the franchisees in the case at bar.

**The Counter-Motion**

27 The first matter to address is what motions are before the court for determination.

28 In this regard, the franchisees apparently believed until near the end of the hearing that they could obtain an interlocutory order enjoining the franchisor from exercising its self-help remedies without a notice of motion seeking interlocutory relief having been delivered and without claiming an injunction in their counterclaim against the franchisor.

29 It was apparently the franchisees belief that if they successfully defended the franchisor's request for interlocutory relief, it would follow that the court would make an order enjoining the franchisor from exercising its self-help remedies in the franchise agreements and maintaining the *status quo*.

30 The fallacy of these beliefs is that while the dismissal of the franchisor's request for relief might create issue estoppels

  

about some issues between the parties, it would not necessarily determine whether the franchisees were themselves entitled to interlocutory relief. For instance, I might have decided not to grant an interlocutory remedy to Quiznos precisely because it had self-help remedies and did not need the court's remedial assistance.

31 Thus, from the franchisees' perspective, they did need the counter-motion that they eventually tendered to the court. Quiznos, however, has objected to the late arriving counter-motion. Thus, there is a question about what requests for relief are before the court for decision.

32 As I noted in the introduction and overview, notwithstanding its late delivery, I have decided to accept the delivery of the franchisees' notice of motion and to rule on the merits of the franchisees' requests for relief.

33 My first reason for these decisions is that I see no substantial prejudice to the franchisor in proceeding in this way. As I have already noted, the franchisor always anticipated that there would be a counter-motion, and given that the legal and factual issues of the anticipated counter-motion largely mirror the issues of the franchisor's motion, and given that there was no additional factual material filed in support of the counter-motion, it is unlikely that the franchisor was prejudiced in any meaningful way by the late arrival of the anticipated motion.

34 Mr. Shaw for the franchisor argued that the franchisor's cross-examinations of the franchisees and the franchisor's argument of the motion might have been designed differently if the franchisees had delivered their counter-motion in a timely way. That may be true, but I think that the question is not whether the franchisor might have done something different but whether the franchisor had sufficient notice of the franchisees' case and an opportunity to meet that case. In my opinion, regardless of whether the franchisee's case was stated by way of defence or by way of affirmative claim, the franchisor has not been prejudiced and it is unlikely that it would have conducted its own case much differently than it was presented.

35 My second reason is that all the parties are better served if the court is able to make an order that comprehensively determines all the competing claims for interlocutory relief that could and should have been made by the parties when the franchisor put its rights before the court. Both parties have now had their days in court, and it makes little sense to make an order on the plaintiffs' motion that leaves uncertain how the defendants' counter-motion should be determined.

36 Therefore, I am going to proceed as if the franchisees' counter-motion had been delivered in a timely and proper way.

**The Test for an Interlocutory Injunction**

37 Both motions before the court request interlocutory injunctions. In *RJR-MacDonald Inc. v. Canada (Attorney General)*, [1994] 1 S.C.R. 311 (S.C.C.), the Supreme Court of Canada described the test to be applied in deciding whether to grant an interlocutory injunction. Under the *R.J.R. MacDonald* test, the court considers three factors: (a) whether the plaintiff has presented a serious issued to be tried or, in a narrow band of cases, a strong *prima facie* case; (b) whether the plaintiff would suffer irreparable harm if the remedy for the defendant's misconduct were left to be awarded at trial; and (c) where does the balance of convenience or inconvenience lie in the granting or the refusing to grant an interlocutory injunction.

38 For most cases, the first factor of the strength of the plaintiff's case sets a low threshold, and this factor negates the need of any in-depth review of the merits at the preliminary phase of the proceedings. If the action is shown not to be frivolous or vexatious, then it has satisfied the low threshold. However, a higher threshold of showing a strong *prima facie* case is required where the outcome of the interlocutory injunction, practically speaking, will make proceeding to trial pointless for one party or when the plaintiff's right can only be exercised immediately or not at all.

39 The strong *prima facie* case standard involves a more intensive examination of the merits of the plaintiff's case. Since a "*prima facie* case" is established when on the balance of probabilities it is likely that the plaintiff will succeed, I understand a "strong *prima facie* case" to involve a higher level of assurance at the interlocutory stage that it is likely that the plaintiff will succeed at the trial. In the context of claims for mandatory injunctions, a strong *prima facie* case has been interpreted to mean that the plaintiff must satisfy the court that he or she is clearly right and is almost certain to be successful at trial. Given the very intrusive nature of a mandatory injunction, there must be a high assurance that the injunction would be rightly granted. See *Barton-Reid Canada Ltd. v. Alfresh Beverages Canada Corp.*, [2002] O.J. No. 4116 (Ont. S.C.J.) at para. 9; *Benjamin v. Toronto Dominion Bank* (2006), 80 O.R. (3d) 424 (Ont. S.C.J.) at para. 27.

  

40 I do not, however, understand the requirement of showing a strong *prima facie* case to go so far as to require the plaintiff to actually prove his or her case. If this were true, a trial would be superfluous and the interlocutory motion would move from being an examination of the strength of the case to an actual determination of the merits of the case. In paragraph 2.130 of the leading Canadian text about injunctions and specific performance, *Injunctions and Specific Performance* (Canada Law Book: Aurora, 2008, loose leaf), Justice Robert Sharpe states that the question of whether the plaintiff has shown a strong *prima facie* case "probably means no more than, if the court had to finally decide the matter on its merits, on the basis of the material before it, would the plaintiff succeed?"

41 The strong *prima facie* test standard is the measure used for determining whether it is appropriate to enforce a restrictive covenant by an injunction that would restrain an individual's cherished ability to make a living and to use his or her knowledge and skills obtained during employment: *Boehmer Box L.P. v. Ellis Packaging Ltd.*, [2007] O.J. No. 1694 (Ont. S.C.J.); *Sherwood Dash Inc. v. Woodview Products Inc.*, [2005] O.J. No. 5298 (Ont. S.C.J.); *1259695 Ontario Inc. v. Guinchard*, [2005] O.J. No. 2049 (Ont. S.C.J.); *Kohler Canada Co. v. Porter*, [2002] O.J. No. 2418 (Ont. S.C.J.).

42 In the case at bar, for Quizno's claim for injunctive relief, I will apply the standard of showing a strong *prima facie case*, by which I mean a showing of a strong case with a high although not absolutely assured likelihood of success based on the material presently before the court.

43 In contrast, for the franchisee's claim for injunctive relief, I will apply the standard of showing a serious issue to be tried. Granting an interlocutory injunction for the franchisees would not involve a final determination of the rights of the parties and rather would maintain the *status quo* pending a trial determination that might end or continue that status. Further, in my opinion, enjoining Quizno's Canada from terminating the franchise would be a restrictive injunction and not a mandatory injunction. Thus, the appropriate standard is that of showing a serious issue to be tried. On these points, see: *TDL Group Ltd. v. 1060284 Ontario Ltd.*, [2001] O.J. No. 3614 (Ont. Div. Ct.); *Erinwood Ford Sales Ltd. v. Ford Motor Co. of Canada Ltd.*, [2005] O.J. No. 1970 (Ont. S.C.J.); *674834 Ontario Ltd. v. Culligan of Canada Ltd.*, [2007] O.J. No. 979 (Ont. S.C.J.); *1323257 Ontario Ltd. v. Hyundai Auto Canada Corp.*, [2009] O.J. No. 95 (Ont. S.C.J.).

44 The second element of the test for an interlocutory injunction is irreparable harm. In determining whether the plaintiff would suffer irreparable harm, the court will consider whether damages awarded after a trial will provide the plaintiff with an adequate remedy without the need for an interlocutory remedy: *Traynor v. UNUM Life Insurance Co. of America* (2003), 65 O.R. (3d) 7 (Ont. Div. Ct.); *Paddington Press Ltd. v. Champ* (1979), 43 C.P.R. (2d) 175 (Ont. H.C.); *Evans Marshall & Co. v. Bertola S.A.* (1972), [1973] 1 W.L.R. 349 (Eng. C.A.) at p. 379. If damages or some other trial remedy would come too late or be inadequate to repair the harm or to do justice, then the harm may be said to be irreparable.

45 When the plaintiff shows a sufficiently strong case and irreparable harm, the analysis moves to the balance of convenience element, which considers what is the effect on the parties, and sometimes on third parties, of the court granting or not granting the interlocutory injunction. The third element involves a determination of which of the two parties will suffer the greater harm from the granting or the refusal to grant an interlocutory injunction pending a decision on the merits.

46 In considering the balance of convenience, it is appropriate to reconsider the comparative strength of the parties' cases. If the plaintiff's case seems weak, then the undoubted convenience of an injunction may not balance the inconvenience of the defendant suffering the interference with his or her rights based on a doubtful claim. Conversely, if the merits of the plaintiff's case seem quite strong then the plaintiff's inconvenience of being denied an interlocutory remedy may seem to outbalance the inconvenience of the defendant having to suffer a restraint on his or her rights.

**The Factual Background and the Factual Foreground**

47 I turn now to the factual background and the factual foreground for the two motions before the court. As already mentioned above, the franchisees urge the court to consider matters beyond the contractual relationship between the parties including the significance of the motion for interlocutory relief to an outstanding class proceeding. Thus, the dispute between Quizno's Canada and the three franchisees has both a factual background and a factual foreground.

48 In the factual background is the larger context of the relationship between the franchisor and the franchisees in both

  

Canada and the United States. In the background are the class action and other litigation involving Quiznos franchisees in Canada and in the United States. In the factual foreground are the circumstances of the contractual relationship between Quizno's Canada and the three franchisees and the events of the last year and a half that occurred at the three Oakville restaurants.

49 Some of the background and foreground facts are common ground. However, the parties dispute the truth, admissibility, relevance, materiality, or legal significance of much of the evidence advanced in support of their two motions. It is not for me, but for a trial judge, to decide the numerous factual controversies. Given the test for interlocutory relief, described above, my description of the facts can and should be done without deciding the merits of the competing claims and without making a final determination about most disputed matters. For my part, in this section of my Reasons for Decision, I will describe the factual background and foreground to the extent necessary to decide the two motions, although I will save some details about factual matters for discussion later when I consider the application of the law to the requests for relief made in the two motions.

50 At the outset of this discussion of the facts and by way of an overview it is helpful to observe that the relationship of the parties has gone through three phases. During the first phase, it appears that there was a friendly relationship and the franchisees appear to have been viewed favorably. In the second phase, which involves the activities of the Canadian franchisee association, events in both Canada and the United States, and the class action in Canada, it appears that the parties began to view each other as foes and perhaps as mortal enemies. In the third phase; that is, during the last year and a half, the relationship has deteriorated until it has now reached the point that the franchisor has taken steps to end it. The franchisor submits that the termination is lawful and justified. The franchisees submit that the termination is unlawful and retaliatory.

51 Also at the outset of this discussion of the facts, I note that Quizno's Canada relies on 11 customer complaints as evidence of under-proportioning, and it relies on other customer complaints as evidence of other breaches of the franchise agreements by the franchisees. For the purposes of deciding the two motions before the court, and with a slight exception for the evidence of Ms. Jane Fisher, of which more will be said below, beyond accepting that the complaints were made, I give no significance to them. I also give no weight to the evidence and allegations about whether there has been a fundamental breakdown in the ability of the parties to have a business or contractual relationship one with the other. These matters may be for the trial judge to determine. In my opinion, whether Quizno's Canada is entitled to any interlocutory relief should be determined with respect to the circumstances of the allegations of breach of the franchise agreements that are referred to in the three notices of termination dated February 4, 2009, mentioned below.

52 Proceeding in this way, the following factual background and foreground emerges.

53 Quiznos restaurants are participants in the very competitive fast food market in Canada and in the United States. The Quiznos restaurants pride or distinguish themselves by offering toasted subs that they claim to be superior in both quality and quantity than the competing perhaps lower priced products of their competitors.

54 In 2001, after investigating the Quiznos franchise system, the Johnsons decided to open a Quiznos restaurant in Oakville. By the spring of 2005, they had opened two more Quiznos restaurants in Oakville. As franchisees, they all signed standard form Quiznos franchise agreements. For present purposes, the important contract terms are sections 2.2, 8.1, 11.1, 12.1, 13.1, 13.2, 18.2, 18.3, 18.7 and 20.3. These are the provisions that Quizno's Canada relies on in support of its positions that the franchise agreements have been breached and lawfully terminated and that the franchisees are breaching their post-termination obligations. With exceptions for the provisions in the franchise agreements describing the obligations of the franchisee upon termination (section 18.7) and the post-termination covenant not to compete (section 20.3), I will set out the relevant portions of the franchise agreements later in this narrative when they become important. I will not set out sections 18.7 and 20.3 because I have already described them in the introduction of these Reasons for Decision.

55 Beginning in 2004 Quiznos franchisees began to express complaints over the costs of goods under their franchise agreements. However, up until at least early 2006, there appears to have been no direct problems between the parties to the case at bar. The franchisees received awards from Quiznos for the best training store in Canada and for highest average unit volume in Eastern Canada.

56 The friendliness, however, seems to have ended in 2006. In January 2006, the Denver Subs Canada Franchise

  

Association was formed by franchisees to deal with what they believed to be overcharging by the franchisor. The first president of the association was Mr. Jonathan Talbot-Kelly, who owned five restaurants in the Maritime Provinces. It is alleged by the franchisees in the case at bar that Quiznos took steps to thwart the efforts of Denver Subs and to retaliate against Mr. Talbot-Kelly for his pursuit of fair pricing. The retaliation included suing him, excluding him from an advisory council established by Quiznos, and terminating an agreement with him, although not his franchises. One outcome of this confrontation was that Mr. Talbot-Kelly resigned as president of Denver Subs, and in the fall of 2006, Mr. Douglas Johnson was elected in his place.

57 On May 12, 2006, with Mr. Johnson's Cornwall Rd. Restaurant as one of the plaintiff's, a class action against Quizno's Canada and several others was commenced. The plaintiffs in the class action allege, amongst other things, a conspiracy and price maintenance by Quizno's Canada contrary to s. 61 of the *Competition Act* and a breach of the duty of fair dealing under Ontario's *Arthur Wishart Act (Franchise Disclosure), 2000*, S.O. 2000, c. 3.

58 Mr. Johnson alleges that after his appointment as President of Denver Subs, and with his role in the class proceedings, he became the target of retaliatory and punitive measures by Quizno's Canada. Like Mr. Talbot-Kelly, he was removed as a representative on the advisory council. Mr. Johnson alleges that he and his nephew have been victims of a smear campaign and that their restaurant franchises have been subject to harassing inspections. He alleges that Quiznos attempted to isolate him from other franchisees and that Quiznos ignores him or fails to respond to his requests for information, assistance, or service.

59 Mr. Johnson alleges that in the context of the class proceedings, Quiznos has wrongfully attempted to contract the class members directly without prior court approval to solicit releases and to undermine the class proceeding and his role as representative plaintiff. He also alleges that Quiznos has a history of abusive retaliation against the leaders of independent franchisee associations both in Canada and in the United States including wrongfully terminating their franchises. As proof, he refers to the recent decision of U.S. District Judge Morris B. Hoffman in *Quizno's Franchising v. Zig Zag Restaurant Group* [, Doc. 06CV10765 (U.S. Colo. Dist. Ct. December 31, 2008)]. He relies on this history as proof that the terminations in the case at bar are illegitimate.

60 Turning then to those terminations, Quizno's Canada justifies them as a lawful response to breaches of the franchise agreements that genuinely occurred, and it denies that the terminations are retaliatory or intended to interfere with the franchisees rights of association or with the class proceeding. They say that the terminations arise as a result of breaches of the franchise agreement discovered by inspections or customer complaints. In this last regard, to ensure quality control at its franchisees' restaurants, Quizno's Canada exercises its right to inspect, which is provided for in section 13.2 of the franchise agreement. Section 13.2 states:

> 13.2 Inspections. QCC shall have the right to interview customers or examine the Franchised Location ... including without limitation the inventory, products, equipment, materials or supplies, to ensure compliance with all standards and specifications set by QCC. QCC shall be entitled to conduct such inspections during regular business hours without prior notice to Franchisee.

61 Inspections include the use of "mystery shoppers," who are third parties that covertly inspect franchisees to ensure that they are complying with Quizno's Canada's standards for its products and business practices. In the case at bar, the mystery shoppers are not employees of Quiznos but rather are engaged by Sensors Quality Management Inc. and Service Sleuth, which are independent corporations retained by Quizno's Canada to engage the mystery shoppers. The franchisees know that they may be inspected in this fashion.

62 During the two and a half month period between November 23, 2007 and January 14, 2008, and in September 2008, and in January 2009: seven products at the Cornwall Rd. restaurant were purchased by mystery shoppers; nine products at the Dundas restaurant were purchased by mystery shoppers; and six products at the Third Line restaurant were purchased by mystery shoppers. It is alleged by Quizno's Canada that the mystery shoppers reported under-proportioning for these 22 food audits.

63 Quizno's Canada submits that under-proportioning is a breach, at least, of sections 2.2, 8.1, 11.1 and 13.1 of the

  

franchise agreement. Sections 2.2, 8.1 and 13.1 are set out immediately below [emphasis added]. Section 11.1 is set out later in these Reasons for decision.

> **2.2 Scope of Franchise Operations.**
>
> Franchisee agrees at all times to faithfully, honestly and diligently perform Franchisee's obligations hereunder, to use best efforts to promote its Restaurant and to not engage in any other business or activity that conflicts with the operation of the Restaurant in compliance with this Agreement. **Franchisee agrees** to utilize the Marks and Licensed Methods **to operate all aspects of Franchisee's Restaurant in accordance with the methods and systems developed and prescribed from time to time by QCC, all of which are part of the Licensed Methods**. Franchisee's Restaurant shall offer all products and services designated by QCC, all of which are part of the Licensed Methods. Franchisee's Restaurant shall offer all products and services designated by QCC, which may include, without limitation, restaurant services offered in conjunction with a distinctive theme and décor and a uniform menu and style offering specialty and other sandwiches, salads and other food and beverages. Franchisee shall implement any additions and changes to the products and services offered by its Restaurant required by QCC.
>
> **8.1 Operations Manual**
>
> QCC agrees to loan to Franchisee one or more manuals, technical bulletins or other written or videotaped materials (collectively referred to as "Operations Manual") **covering the proper operating and marketing techniques** of the Restaurant. **Franchisee agrees that it shall comply with the Operations Manual as an essential part of its obligations under this Agreement.** Franchisee shall at all times be responsible for ensuring that its employees and all other persons under its control comply with the Operations Manual in all respects.
>
> **13.1 Standards and Specifications.**
>
> QCC will make available to Franchisee, QCC's standards and specifications for services and products offered at or through the Restaurant and the uniforms, recipes, materials, forms, menus, items and supplies used in connection with the franchised business. QCC reserves the right to change standards and specifications for services and products offered at or through the Restaurant or for the uniforms, recipes, materials, forms, items and supplies used in connection with the franchised business upon 30 days prior written notice to Franchisee.

64 The methodology, validity and integrity of the food audits by the mystery shoppers are challenged by the three franchisees. In any event, as indicated here and below, Quizno's Canada took steps only with respect to some of the instances of alleged under-proportioning. Thus, on February 5, 2008, Quizno's Canada served each of the franchisees with written notice that the franchisees were in default for under-proportioning sandwiches.

65 Meanwhile, on March 4, 2008, I dismissed the motion for certification of the class action.

66 In the summer of 2008, Quizno's Canada required all of its franchisees to participate in the "$5 after 5PM Promotion." Quizno's Canada submits that this obligation may be imposed pursuant to sections 2.2 (set out above), 11.1 (set out later in these Reasons for Decision) and 12.1 of the franchise agreement. Section 12.1 of the franchise agreement states [emphasis added]:

> 12.1 Approval of Advertising .... Franchisee acknowledges that **advertising and promoting** the Restaurant in accordance with QCC's standards and specifications is an essential aspect of the Licensed Methods and **Franchisee agrees to comply with all advertising standards and specifications established by QCC**.

67 Relying on sections 2.2 and 11.1 of the franchise agreement, in July 2008, Quizno's Canada sent a series of notices of default for the alleged failure of the three franchisees to participate in the "$5 after 5PM Promotion."

68 After receiving legal advice from a lawyer specializing in Canadian franchise law, the franchisees advised Quizno's Canada that the franchise agreements do not require the franchisees to follow Quizno's Canada's promotions. The

  

franchisees' legal counsel advised Quizno's Canada that there was no provision in the agreements that requires the restaurants to sell products at prices determined by Quizno's Canada. The franchisees rely on the fact that in other franchise agreements with other franchisees, s. 12.1 contains the sentence "Franchisee also agrees to participate in any promotion campaigns and advertising and other programs that Franchisor periodically establishes." The franchisor obviously argues that the additional wording in other contracts does not detract from the breadth of the current language of section 12.1.

69 On October 28, Quizno's Canada sent two of the franchisees written notice that the franchisees were in default for under-proportioning sandwiches.

70 In the fall of 2008 having already tested the project in London, Ontario and Ottawa, Ontario, Quizno's Canada directed its franchisees in the Greater Toronto Area, which territory includes Oakville and the territory of the three franchisees in the case at bar, to implement a program offering delivery service to customers who placed orders by phone or online. In imposing the delivery program, Quizno's Canada relies on section 11.1 of the franchise agreement, which states [emphasis added]:

> 11.1 Business Operations. Franchisee acknowledges that it is solely responsible for the successful operation of its Restaurant and the continued operation thereof is partially dependent upon Franchisee's compliance with this Agreement and the Operations Manual. In addition to all other obligations contained herein and in the Operations Manual, Franchisee covenants that:
>
> (a) **Franchisee** shall operate a clean, safe, and high quality Restaurant operation and **shall promote and operate the business in accordance with the Operations Manual and in such a manner as not to detract from or adversely reflect upon the name and reputation of Franchisor** or QCC and the goodwill associated with the QUIZNO'S name and Marks;
>
> (d) **Franchisee acknowledges that the franchise granted hereunder requires and authorizes Franchisee to offer only authorized products and services as are fully described in the Operations Manual, which may include**, without limitation submarine and other sandwiches, salads and other authorized food and beverage products **and related restaurant and carry out or delivery services**. .... **Franchisee shall offer all types of services and products as from time to time may be prescribed by QCC** and shall not offer any other types of services or products ....

71 There are controversies between the parties about: the desirability of the delivery program; the adequacy of its testing; the evaluation of its testing; its profitability; its consequential advantages and disadvantages; and whether Quizno's Canada breached duties of good faith and fair dealing in introducing the delivery program. The franchisees submit that the program has not been adequately tested and has been introduced without regard to the franchisees' legitimate commercial interests. They submit that franchisees are being threatened with legal action and being pushed into participating in the delivery program by misleading and incomplete information.

72 The franchisees submit that the requirement to participate in the delivery program and, for that matter, any requirement to participate in promotions, must be considered in light of Quizno's Canada's duties of good faith and fair dealing under s. 3 of the *Arthur Wishart Act (Franchise Disclosure), 2000*, S.O. 2000, c. 3, which states:

> **Fair dealing**
>
> 3. (1) Every franchise agreement imposes on each party a duty of fair dealing in its performance and enforcement.
>
> (2) A party to a franchise agreement has a right of action for damages against another party to the franchise agreement who breaches the duty of fair dealing in the performance or enforcement of the franchise agreement.
>
> (3) For the purposes of this section, the duty of fair dealing includes the duty to act in good faith and in accordance with reasonable commercial standards.

  

73 There are also controversies about the impact, if any, of the three franchisees having not participated in the delivery program to date. More precisely, it is disputed whether Quizno's Canada has actually suffered irreparable harm by the franchisees non-participation in the delivery program.

74 However, not disputed is that the franchisees have not yet participated in the delivery program and that on December 1, 2008, Quizno's Canada served each of the them with a notice of default regarding their failure to implement the delivery program. Further notices were sent on December 19, 2008.

75 In December 2008 through January 2009, Quizno's Canada required all its franchisees to participate in the "$5 Large Everyday Value Subs Promotion."

76 On January 23, 2009, relying on sections 11.1 and 12.1 of the franchise agreement, Quizno's Canada sent the three franchisees notices of default for an alleged failure to participate in the "$5 Large Everyday Value Subs Promotion." The franchisees' position with respect to their alleged failure to participate in this promotion is set out in paragraph 131 of their factum, which states:

> 131. The defendants were in fact offering the new sandwiches introduced by the "Event 1" campaign and following every aspect of the campaign save one. The only aspect which they did not follow was the price. The defendants asserted, through their counsel, that they were not required to do so under the stores' franchise agreements. Quiznos was fully aware of this legal position and the basis for it. It sought no legal determination on whether or not it could oblige the defendants to comply with the price in the absence of such an obligation in the franchise agreement.

77 I pause and digress here to note with respect to the last sentence in paragraph 131 that the franchisees also did not seek a legal determination about whether they were obliged to fully comply with the promotion. I will return to this topic in the concluding section of these Reasons for Decision.

78 Returning to the narrative, on January 28, 2009, Quiznos served all three franchisees with written notice that the franchisees were in default for under-proportioning sandwiches.

79 Thus in the last year and a half, notices of default have been served with respect to allegations of: (1) selling under-portioned sandwiches to customers; (2) failing to participate in promotions; and (3) failing to provide the delivery service as directed by Quizno's Canada.

80 On February 4, 2009, relying on sections 18.2 (k) and 18.3 of the franchise agreements, Quizno's Canada served the three franchisees with written notices of termination. Sections 18.2 (k) and 18.3 state:

> **18.2 Termination by QCC - Effective upon Notice.**
>
> QCC shall have the right, at its option, to terminate this Agreement and all rights granted Franchisee hereunder, without affording Franchisee any opportunity to cure any default, effective upon receipt of notice by Franchisee, upon occurrence of any of the following events:
>
> **(k) Repeated Noncompliance.**
>
> If Franchisee has received three notices of default under this agreement from QCC within a 12-month period, regardless of whether the defaults were cured by Franchisee;
>
> **18.3 Termination by QCC - Thirty Days Notice.**
>
> QCC shall have the right to terminate this Agreement effective upon 30 days prior written notice to Franchisee, if Franchisee breaches any other provision of this Agreement, including but not limited to, if Franchisee fails to substantially comply with the Operations Manual, and fails to cure the default during such 30-day period. In that event, this Agreement will terminate without further notice to Franchisee, effective upon expiration of the 30 day period. Notwithstanding the foregoing, if the breach is curable, but is of a nature which cannot reasonably be cured within such

  

> 30-day period and Franchisee has commenced and is continuing to make good faith efforts to cure the breach during such 30-day period, Franchisee shall be given an additional reasonable period of time to cure the same, and this Agreement shall not terminate.

81 Each of the notices of termination state:

> You are hereby advised that Franchisee's rights under the Agreement are terminated, effective immediately, pursuant to section 18.2 (k) for repeated noncompliance, and pursuant to section 18.3 for failure to timely cure defaults relating to failure to offer delivery services, failure to adhere to Quizno standards and specifications, and failure to participate in promotional campaigns and other advertising and marketing programs.

82 On February 7, 2009, Ms. Jane Fisher visited the Dundas St. Restaurant with her son. She eventually lodged a complaint as a result of what happened on this visit when she was advised apparently rudely that the "$5 Dollar after 5 Promotion" was not available unless she wanted a turkey or tuna sub, which she did not.

83 Around this time, it was arranged that I should hear Quizno's Canada's motion and although I had already set a schedule for the hearing of the interlocutory motion, the lodging of Ms. Fisher's complaint prompted Quizno's Canada to seek an interim order. Thus, based on the record placed before me on February 18, 2009, I ordered that an independent observer be present for any further inspections by Quizno's Canada. No further inspections occurred, and the parties completed cross-examinations and filed their material for Quizno's Canada's motion.

84 Ms. Fisher also swore an affidavit for Quizno's Canada's motion. In that affidavit, she repeated her complaint. She was not cross-examined, and the only aspect of her evidence that is seriously disputed is whether she was rudely directed to go somewhere else to purchase a sandwich for her son. For present purposes, I do not find it necessary to make any findings about her evidence beyond saying that it confirms the evidence that the franchisees do not comply fully with Quizno's Canada's promotions. The franchisees' position, however, remains that they are free to participate in promotions as they may be inclined without breach of the franchise agreement.

85 For the interlocutory motions, in addition to the parties providing disputed evidence about the alleged breaches of the franchise agreement, there was quite a bit of evidence about the metrics of sandwich construction and about the anticipated profitability of Quizno's Canada's delivery program. Further, as already mentioned in the introduction to these Reasons for Decision, both parties provided evidence and argument about irreparable harm and about the balance of convenience, of which matters I will say more below.

**The Competing Requests for Interlocutory Injunctions**

86 I turn now to the matter of applying the law to the circumstances of the case at bar and the competing requests for interlocutory injunctions.

87 As I stated in the introduction and overview, I have decided to dismiss the franchisees' request for interlocutory relief and to grant Quizno's Canada's motion, as requested. I will expand upon my reasons for these conclusions but a simplification of them is that applying the test for an interlocutory injunction, Quizno's Canada satisfies the first element of the test with respect to the alleged breaches connected with the promotions and the delivery program, although not with respect to the under-proportioning allegations, and, in my opinion, it also satisfies the second and third elements of irreparable harm and the balance of convenience.

88 More particularly, having considered the evidence filed on this motion, I conclude that Quizno's Canada has a strong *prima facie* case of establishing that: (a) without advising Quizno's Canada, the franchisees implemented their own version of the "$5 after 5PM Promotion," in which they did not follow the specifications of Quizno's Canada as to product offering and pricing; (b) without advising Quizno's Canada, the franchisees implemented their own version of the "$5 Large Everyday Value Subs Promotion," in which they did not follow the specifications of Quizno's Canada as to product offering and pricing; (c) without advising Quizno's Canada, the franchisees did not implement other promotions specified by

  

Quizno's Canada; and, (d) the three franchisees have not implemented the delivery program.

89 Further, I conclude that Quizno's Canada has shown a serious issue that the franchisees have breached the franchise agreements by under-proportioning sandwiches. Put another way, the quality of the evidence is such that I am not satisfied that Quizno's Canada has shown a strong *prima facie* case that the franchisees have breached the franchise agreement by under-proportioning sandwiches, but it has shown a serious issue for trial. Therefore, putting aside the matter of under-proportioning, I conclude that Quizno's Canada has a strong *prima facie* case that the franchisees have breached their franchise agreements.

90 In reaching my conclusions about the strength of the case of Quizno's Canada, I have considered the franchisees' argument that they have a strong defence and counterclaim arising from their interpretation of the franchise agreements and from the effect of the *Arthur Wishart Act (Franchise Disclosure), 2000*, S.O. 2000, c. 3. In my opinion, however, the strength of their defence and counterclaim does not go so far as to negate that Quizno's Canada has established a strong *prima facie* case about the promotions and the delivery program (or that it has shown a serious issue for trial about the under-proportioning of sandwiches).

91 To be clear, in determining that the franchisor has shown a strong *prima facie* case, I am obviously not deciding the case on the merits and I am not saying or predicting that the franchisees' defence or counterclaim will necessary fail. Rather, I am just recognizing the reality that the franchisees have already conceded that: (a) they have not fully complied with several promotions; and (b) they have not implemented the delivery program.

92 The promotions and the delivery program were mandated for all franchisees and the alleged breaches by the franchisees are independent of any credibility issues involving Quizno's Canada being motivated to isolate or retaliate against allegedly defiant franchisees or to interfere with the interests of franchisees in the class proceedings. And, at least, in the case of the delivery program, there appears to be express contract language that supports the position of the franchisor. In the case of the promotions, without deciding the point, there is a reasonably strong argument that the existing language of the franchise agreement requires a franchisee to comply with the standards and specifications of the promotions as set by the franchisor.

93 In my opinion, the franchisor will suffer irreparable harm if an interlocutory injunction is not granted and for the reasons discussed further below the balance of convenience favours granting an interlocutory injunction. It would appear that the franchisees would not be able to satisfy a damages award against them and, in any event, the irreparable harm suffered by the franchisor goes to its goodwill, its reputation, and its responsibility to the franchisees of the chain to maintain the integrity of the franchise system. Damages would not adequately address these harms.

94 For their part, the franchisees satisfy the first element of showing a serious issue to be tried that Quizno's Canada has wrongly terminated the franchise agreements.

95 And I am satisfied that the franchisees will suffer irreparable harm unless they are granted an interlocutory injunction that maintains the *status quo* and suspends the termination. The termination of a franchise, the loss or reputation and the loss of goodwill may constitute irreparable harm: *TDL Group Ltd. v. 1060284 Ontario Ltd.*, [2001] O.J. No. 3614 (Ont. Div. Ct.); *Erinwood Ford Sales Ltd. v. Ford Motor Co. of Canada Ltd.*, [2005] O.J. No. 1970 (Ont. S.C.J.); *674834 Ontario Ltd. v. Culligan of Canada Ltd.*, [2007] O.J. No. 979 (Ont. S.C.J.); *1323257 Ontario Ltd. v. Hyundai Auto Canada Corp.*, [2009] O.J. No. 95 (Ont. S.C.J.).

96 The franchisees' request for an injunction, however, fails the balance of convenience test, especially when the comparative strength of their defence is compared with Quizno's Canada strong *prima facie* case that there have been one or more breaches of the franchise agreements.

97 On the elements of irreparable harm and the balance of convenience, there is also the factor that if the interlocutory injunction is denied but Quizno's Canada succeeds at trial, then damages from the franchisees are likely not recoverable but the irreparable harm from the breaches will remain. In contrast, if the interlocutory injunction is granted and Quizno's Canada fails at trial, although the franchisees will have suffered irreparable harm, an award of damages and the enforcement of the undertaking as to damages would go some distance in providing a worthwhile remedy for the wrongful termination of

  

their franchise agreements.

98 Still on the elements of irreparable harm and the balance of convenience, notwithstanding that the Divisional Court has conditionally certified the class action, I do not see the class members suffering irreparable harm from the circumstance that their representative plaintiff's franchise has been terminated. Mr. Johnson's franchise can remain a representative plaintiff, and he can direct class counsel in the class action to lead the evidence about the costs of goods and the franchisees' experience of profits and losses whether or not he is a current franchisee. While I do not diminish the important role of representative plaintiff, there is also the reality that class counsel has an equal or greater incentive to vigorously lead the class in its pursuit of justice.

99 If the case at bar were just about alleged breaches of a franchise agreement with respect to the amount of meat, etc. on submarine sandwiches, then notwithstanding the franchisor's arguments that any under-proportioning by a franchisee(s)s goes to the heart of its goodwill, reputation, and enterprise, nevertheless, I would have found that the franchisor would not suffer irreparable harm if an injunction were not granted, and I further would have found that the balance of convenience did not favour the franchisor. A zero-tolerance to perhaps inadvertent or only occasional harm caused by a breach of a franchise agreement by an individual franchisee or a small number of franchisees in a national franchise chain sets the bar much too low for irreparable harm and the balance of convenience.

100 However, this is not a case just about a breach of the product standards set by the franchisor, which is a serious enough matter; it is about the marketing and manner of operation of the franchise system. In *Franchise Law* (Irwin Law: Toronto, 2005), at p. 325, Frank Zaid describes the nature of a franchise agreement, as follows:

> The essence of a franchise agreement is that the franchisor licenses to the franchisee the rights to use the franchisor's trade marks and business system under specific controls and standards, for a stated period of time, in exchange for financial consideration. The franchisee has access to the franchisor's confidential information and know-how, and learns to operate the franchised business using the franchisor's standards and specifications.

101 By notoriously deciding to go its own idiosyncratic way in participating in promotions and by not participating in the delivery system, the franchisees challenge who has control over: the methods and systems of the franchisor (section 2.2); the content of and compliance with the operations manual (section 8.1); compliance with business operations (section 11.1) and the specifications of advertising and promoting the restaurants (section 12.1). These are matters fundamental to the integrity of the franchise system, and as noted in *Kentucky Fried Chicken Canada v. Scott's Food Services Inc.*, [1997] O.J. No. 3773 (Ont. Gen. Div.) at p.15, rev'd on other grounds, [1998] O.J. No. 4368 (Ont. C.A.); *1017933 Ontario Ltd. v. Robin's Foods Inc.*, [1998] O.J. No. 1110 (Ont. Gen. Div.) at para. 43:

> The most precious possession of a franchisor is its trademark and systems. The practice is to protect those interests in the terms of contracts with the franchisees for the benefit of the franchisor and other franchisees.

102 In *Second Cup Ltd. v. Ahsan*, [2001] Q.J. No. 1763 (C.S. Que.), Justice Zerbisias stated at para. 60:

> 60. Where a member of the franchise chain fails to uphold the policies, standards, and operating methods and system to which all of the franchisees have subscribed by executing their franchise agreement, and upon which they rely to advance their mutual interests, it is incumbent upon the franchisor to take measures against the infringing party to force it to cease from tarnishing the reputation of the chain and from diminishing the value of the trademark and the banner. The franchisor must act to protect the integrity of the chain.

103 Both parties elevate the contest in this case to a battle about who is in charge of the franchise system. The franchisees do so by connecting the dispute in this case with a pursuit for justice for the members of Denver Subs and the class members of a class action and by demanding that the franchisor prove a business case for the delivery system. The franchisor does so by alleging and providing some evidence that the franchisees' conduct has already affected the franchisor's relationship with other franchisees and has interfered with its role as franchisor because other franchisees are following the lead of Mr. Johnson in refusing to implement the delivery system.

  

104 The dispute in this case is not a localized dispute. It is about the franchisor's management rights across the chain of franchises, and this circumstance influences the calculus of irreparable harm and the balance of convenience. In my opinion, given the matters at stake and the strength of their comparative cases and the ineffectiveness of a damages award at trial should the franchisor succeed, the balance of convenience favours granting the franchisor an interlocutory injunction subject to the usual undertaking as to damages.

**Concluding Comments**

105 For the above reasons, I grant the franchisor's motion and dismiss the franchisees' countermotion.

106 In concluding, I wish to return to my observation, made earlier, that neither party in this case sought a judicial determination of whether the franchise agreement requires the franchisees to comply fully with promotions, including the pricing of their products as directed, or whether the franchise agreement requires the franchisees to participate in a delivery program.

107 I believe that these questions could and should have been resolved by application pursuant to Rule 14 of the *Rules of Civil Procedure.* An application can resolve a dispute about contract interpretation. In the case at bar, I appreciate that the dispute about under-proportioning is not a matter of contract interpretation, but it was my impression that the tipping point for the termination notices was the franchisees' refusal to participate in the delivery program.

108 In the case at bar, the dispute about the rights of the franchisor and the franchisees are fundamentally issues of contract interpretation and the factual nexus necessary to decide these issues of contract interpretation would not, in my opinion, be controversial or beyond the parameters of what can be determined by application. For instance, in a proceeding by application, it would not be necessary to determine whether imposing a delivery program was genuinely a prudent or a harmful business decision but the issue would be whether and to what extent as a matter of contract interpretation a decision by the franchisor to require a delivery program was within the scope of the franchisor's rights and the franchisees' obligations under the franchise agreements.

109 Rather than just getting the opinion of their lawyers about the interpretation of the franchise agreements, the parties had the resource of obtaining a binding court ruling interpreting the franchise agreements. The parties could then, as lawyers like to say, govern themselves accordingly. The court ruling could have been obtained without the risk of either party being in breach of the franchise agreements.

110 An early judicial or arbitral determination avoids either party having to suffer irreparable harm by the granting or the refusing to grant an interlocutory injunction. Other franchisees and other franchisors might take a lesson from what happened in the case at bar and if they find themselves with a similar type of problem, they might consider obtaining a court ruling before taking steps that may be found to be breaches of the franchise agreements.

111 For the record, I also note that during the argument of the motions, I suggested to the parties the alternative of placing the three Oakville restaurants under a trusteeship or receivership pending the trial. The trustee or receiver, who might be another franchisee in the chain, would maintain the current employment contracts and manage the restaurants in accordance with the current franchise agreements, thus avoiding irreparable harm to either party pending the trial. Neither side was interested in this suggestion.

112 Finally, there is the matter of costs. Subject to receiving submissions from the parties, my view at present is that the costs of both the motions and the counter-motion should be in the cause, so that the costs of the motions correspond with the parties' success or failure after a trial where the merits of their competing claims will actually be determined.

113 If costs are sought, then the parties' submissions should be in writing beginning with the franchisor within 20 days of the release of these Reasons for Decision followed by the franchisees submissions within a further 20 days.

*Motion granted; counter-motion dismissed.*

 

2009 CarswellOnt 2280, [2009] O.J. No. 1743, 176 A.C.W.S. (3d) 1016

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EB-2019-0242
Brief of Authorities to
AMPCO Submissions for Motion for Stay

**TAB E**

*Atlas-Gest Inc. v. Brownstones Building Corp., 1992 CarswellOnt 2570 (Ont. Gen. Div.)*

1992 CarswellOnt 2570
Ontario Court of Justice (General Division)

Atlas-Gest Inc. v. Brownstones Building Corp.

1992 CarswellOnt 2570

# In the Matter of the Construction Lien Act, 1983

Atlas-Gest Inc., Plaintiff and The Brownstones Building Corporation, The Breakers East Inc., Montreal Trust Company, Montreal Trust Company of Canada and Ursus Capital Corporation, Defendants

Montgomery J.

Judgment: August 13, 1992
Docket: Whitby 38494/91

Counsel: *W.G. Dingwall, Q.C.*, for Defendants The Brownstones Building Corporation, The Breakers East Inc. and Ursus Capital Corporation.

Subject: Civil Practice and Procedure; Corporate and Commercial; Property

**Headnote**

***Montgomery J.*:**

1 A stay is sought of an order appointing a trustee & receiver until an appeal is heard in the Divisional Court.

2 The first attack is that the entire proceeding before Justice Stash was a nullity as to proceeding was by way of motion and not application. In carefully considered reasons Justice Stash rejected that argument. He had two motions before him. He and jurisdiction to decide either under the Mechanics lien Act or the Courts of Justice Act. He concluded he had jurisdiction under the former & dismissed the Companion motion to the same effect with costs. He said in addressing the question of jurisdiction that we are beyond the day of having to choose the appropriate form of action. I agree!

3 Further on an application to stay the status quo should be preserved when possible. I conclude the proceeding is not a nullity.

4 It is argued that the balance of convenience favours the applicants. To compel Ursus to deliver title documents for registration will render the appeal most. The mortgage trust company was in possession before trustee/receiver was appointed.

5 It is argued the appeal can be heard on an expedited basis if so ordered.

6 On the other side of that issue I conclude that the security interest of the Trust Company is imperilled if a stay is ordered. Purchases may back out of deals which are security for the mortgage. Further the lien claimants interests would be further impaired by a stay.

7 While the unit holders of premises who are in possession are not parties they are prejudicial severlly by delay. I am urged to disregard their interests. The Court may protect them under its general jurisdiction of Parens Patriae. Even absent a

 

consideration of purchasers I conclude that the balance of convenience favours the respondents.

8 What Ursus, Breakers & Brownstones all related closely hell companies such to do is joining the que to gain priority. They could have registered the condomenium corporation but [illegible text] to do so notwithstanding a statutory duty.

9 A final & significant point is that the stay sought is against an interlocutory order, from which no appeal his without leave & none was sought.

10 Appointments of the trustee/receiver did not [illegible text] any issues. See *Alpa Lamber v. 786366 Ont Ltd* per Callaghan C & OC Nov 29/91 *Durall Conston v. WA McDonald Ltd*, 25 OR 2nd 371 per [illegible name] J.A. *Moron drywall v. Hyatt* per Lerner J. 1972 30R 189.

11 For the reasons I refer to exercise my discretion to grant a stay.

12 The motion is dismissed. Costs to each respondent payable by the applicant in the sum of $2500.

**End of Document**



  

EB-2019-0242
Brief of Authorities to
AMPCO Submissions for Motion for Stay

**TAB F**

*Donovan v. Sherman Estate, 2019 ONCA 465*

# COURT OF APPEAL FOR ONTARIO

CITATION: Donovan v. Sherman Estate, 2019 ONCA 465
DATE: 20190605
DOCKET: M50447 (C65874)



van Rensburg J.A. (Motion Judge)

BETWEEN

Kevin Donovan

Applicant (Appellant/Responding Party)

and

The Estate of Bernard Sherman and the Trustees of the Estate, and the Estate of Honey Sherman and the Trustees of the Estate

Respondents (Respondents in Appeal/Moving Parties)

Chantelle Cseh and Timothy Youdan, for the moving parties

Kevin Donovan, appearing in person

Heard: May 29, 2019

## REASONS FOR DECISION

[1] This is a motion for a stay of an order of this court pending the filing and disposition of the moving parties' intended application for leave to appeal to the Supreme Court of Canada, and, if leave is granted, pending the final disposition of the appeal.

[2] On December 15, 2017, prominent Toronto businessman and philanthropist Bernard Sherman and his wife, philanthropist Honey Sherman, were found murdered in their home. No one has yet been arrested and the crimes remain under police investigation.

[3] In June 2018, counsel for the estate trustees of the estates of Bernard Sherman and Honey Sherman filed in the Superior Court applications for a certificate of appointment of estate trustee in respect of each estate. On the application of the estate trustees, Dunphy J. granted initial *ex parte* protective orders sealing the applications for a certificate of appointment of estate trustee, the confidentiality application materials, and other documents relating to the administration of the Shermans' estates (the "Sealed Materials").[1]

[4] Following a contested application to open the court files by the respondent, Kevin Donovan (who is Chief Investigative Reporter at the Toronto Star), Dunphy J. ordered on August 2, 2018 that the entire court file be sealed and remain sealed for a period of two years, subject to further order of the court.

[5] That order was set aside on appeal to this court on May 8, 2019. This court ordered that its decision would take effect ten days after being released. Trotter J.A. made an order on consent temporarily suspending the effects of the May 8th

[1] I am told by counsel for the moving parties that the Sealed Materials include everything that has been and continues to be filed in the Superior Court concerning the administration of the two estates. They also confirm Mr. Donovan's expectation that the entire court file, including all documents filed after Dunphy J.'s order was made, will become public when any stay of this court's order expires.

order and providing for the continued sealing of the Sealed Materials pending the determination of this motion.

[6] The motion is brought under s. 65.1 of the *Supreme Court Act*, R.S.C. 1985, c. S-26. Section 65.1(2) provides that such a motion may be brought before the serving and filing of the notice of application for leave to appeal, if the judge hearing the motion is satisfied that the party seeking the stay intends to apply for leave to appeal and that delay would result in a miscarriage of justice.

[7] The moving parties have 60 days from May 8th to apply to the Supreme Court for leave to appeal. It was essential that they move quickly for a stay, before they had served and filed their notice of application for leave to appeal, as this court's order allowing the appeal provided for the Sealed Documents to be unsealed within ten days. There is no question that the moving parties intend to apply for leave to appeal, and they have clearly articulated the grounds they propose to argue in their application to the Supreme Court. I am satisfied that they have met the test under s. 65.1(2).

[8] The test on a motion for a stay of an order of this court pending an application for leave to appeal to the Supreme Court of Canada, was set out by Strathy C.J.O. in *Livent Inc. v. Deloitte & Touche*, 2016 ONCA 395, 131 O.R. (3d) 784 (in Chambers), at paras. 4-5. The factors to be considered are: (1) whether there is a serious question to be determined; (2) whether the moving party will

suffer irreparable harm if the stay is not granted; and (3) whether the balance of convenience favours a stay. The factors are not to be treated as watertight compartments and the strength of one factor may compensate for weaknesses of another. The overarching consideration is whether the interests of justice call for a stay. See also *BTR Global Opportunity Trading Limited v. RBC Dexia Investor Services Trust*, 2011 ONCA 620, 283 O.A.C. 321 (in Chambers), at para. 16.



**(1) Serious Question to be Determined**

[9] With respect to the first factor, whether there is a serious issue to be determined requires a preliminary assessment of the merits of the proposed appeal, as well as the merits of the proposed leave application. The assessment at this stage is described as a "low threshold": *Livent Inc.*, at paras. 7-8.

[10] In considering whether the appeal would raise a serious issue, I note that this court and the application judge differed in their conclusions as to whether the first part of the *Sierra Club* test (*Sierra Club of Canada v. Canada (Minister of Finance)*, 2002 SCC 41, [2002] 2 S.C.R. 522) was met. The application judge concluded on the evidence filed that the first part of the test was met – that the sealing order was necessary to prevent a serious risk to the privacy and safety of the trustees and beneficiaries of the two estates. He then applied the second part of the test to conclude that the salutary effects of the order sought outweighed its

deleterious effects, including the effects on the right to free expression and the public interest in open and accessible court proceedings.

[11] On appeal, this court concluded that the privacy interests were not properly considered at the first stage of the *Sierra Club* test and that it was not an inference from the evidence, but speculation, that the disclosure of the contents of the estate files posed a real risk of serious physical harm to the beneficiaries and trustees.

[12] In *Baier v. Alberta*, 2006 SCC 38, [2006] 2 S.C.R. 311 (in Chambers), Rothstein J. noted that the extensive reasons of two levels of court, which came to different conclusions, made it apparent that there was a serious issue: at para. 16(a). Similarly in this case, a review of the reasons of the application judge and this court makes it clear that the central issue in dispute between the parties – whether public access to certain estate files should be denied, in whole or in part, for some period of time – raises a serious question.

[13] The real issue on this part of the test is whether there is any arguable merit to the proposed application for leave to appeal. Leave to appeal is granted sparingly in civil matters, and must meet the test under s. 40(1) of the *Supreme Court Act*. The question is whether or not it is likely that the Supreme Court would grant leave. Typically, leave is granted under s. 40(1) of the *Supreme*

*Court Act* only where the proposed appeal raises an issue of public or national importance.

[14] The issues the moving parties intend to raise in their application for leave to appeal to the Supreme Court are identified and explained at some length in their factum on the stay motion, at paras. 36 to 51. Essentially, the proposed appeal would raise questions about (1) the appropriate analytical framework for an order restricting public access to court files involving non-litigious or "administrative" matters – something the Supreme Court has not yet determined; (2) whether, in the digital age, and having regard to the evolving jurisprudence concerning personal privacy, a person's privacy interests can amount to an important public interest at the first stage of the *Sierra Club* test; and (3) whether this court departed from relevant Supreme Court jurisprudence in concluding that the risk of harm was speculative and in failing to consider "objectively discernable harm".

[15] Mr. Donovan argues that there is no serious issue in this case because the law is settled. The proposed appeal involves a dispute about the application of the test for sealing orders, which has been consistently stated by the Supreme Court over the past 30 years. Mr. Donovan asserts that this court simply concluded, in its decision on the appeal, that the evidence was not sufficient to show a real, as opposed to a speculative, risk of serious harm to a public interest. He contends that the failure of the moving parties to move to file fresh

evidence before this court undercuts their argument that there is a risk to personal safety if the court file is not sealed, and that the real concern here is personal privacy, which this court determined was not an important public interest to protect at the first stage of the *Sierra Club* test.

[16] I am satisfied that the low threshold of the first part of the test for a stay is met. The moving parties' proposed application for leave to appeal to the Supreme Court has some arguable merit. Although the application arises in the context of a civil matter, the foundation of the dispute engages important public interests, and the issues the moving parties seek to raise on a further appeal go beyond the simple application of a known test to given facts and would transcend the facts of this particular case. The first part of the test therefore favours the order sought by the moving parties.

**(2) Irreparable Harm**

[17] Here the moving parties say that if the order requested is refused, they will be irreparably harmed because the intended application for leave to appeal, and, if leave is granted, the appeal itself, will be rendered moot.

[18] Mr. Donovan argues that there will be no irreparable harm because this court has already determined that any harm that could result from the lifting of the sealing order is purely speculative. Mr. Donovan's focus is on the harm to an important public interest required under the first part of the *Sierra Club* test.

[19] Irreparable harm for the purpose of a stay motion is generally "harm which either cannot be quantified in monetary terms or which cannot be cured": *Livent Inc.*, at para. 10, citing *RJR-MacDonald Inc. v. Canada (Attorney General)*, [1994] 1 S.C.R. 311, at p. 341. The focus here is on the harm that would result to the moving parties if the order in question were not stayed pending their application for leave to appeal.

[20] I am satisfied that the moving parties would suffer irreparable harm if they were denied a stay, because their proposed application for leave to appeal, which I have concluded has arguable merit, would become moot. In *Provincial Court Judges' Association of British Columbia v. British Columbia (Attorney General)*, 2018 BCCA 477, 430 D.L.R. (4th) 670 (in Chambers), the contested production of a Cabinet document was at issue. Bennett J.A. granted a stay of the B.C. Court of Appeal's order for production of the document, pending an application for leave to appeal to the Supreme Court. She accepted that, if the stay were refused, the proposed appeal would be rendered moot, which would irreparably harm the moving party "by disseminating potentially constitutionally-protected confidential information that might, at the end of the process, continue to be protected. In other words, the horse will be out of the barn": at para. 43.

[21] The same reasoning applies to this case. Refusal of a stay of this court's order would mean that the Sealed Materials would form part of the public record,

resulting in the release of information that, if the appeal process were to run its course, might be protected.

**(3) Balance of Convenience**

[22] There is no affidavit evidence from the respondent addressing the harm that will arise if the stay is granted. Mr. Donovan relies on the delay that has already transpired since he first sought access to the estate files in July 2018, and that will continue while the moving parties seek leave to appeal to the Supreme Court. The delay is in having access to information about the administration of the Sherman estates. The moving parties assert that there is no particular urgency for public access to the contents of the court file.

[23] I am satisfied that the delay that Mr. Donovan and other members of the public would experience in obtaining access to the Sealed Documents before the application for leave to appeal is determined is outweighed by the irreparable harm that would follow if a stay were refused. The order sought has the effect of preserving the *status quo* during the relatively short period of time required for the determination of the moving parties' application for leave to appeal to the Supreme Court. If leave is refused, then the order of this court reversing the sealing order will take effect at that time – likely within a matter of a few months. If leave is granted, it will be up to the Supreme Court to determine whether the Sealed Materials will continue to be sealed pending disposition of the appeal.

[24] Finally, Mr. Donovan argues that, rather than staying the entire order of this court, I should redact the information that is truly confidential, and permit the balance of the court file to be opened to the public.

[25] I am not prepared to do so. Dunphy J., in granting the confidentiality order, and after reviewing the two estate files with an eye to determining whether there were parts that could be disclosed without revealing the names, addresses or bequests left to beneficiaries of either estate or the names and addresses of the trustees, concluded that there was "simply no meaningful part of either file that could be disclosed after making the number of redactions necessary to satisfy those conditions." In the appeal to this court, it was unnecessary to consider any possible redactions. What Mr. Donovan is asking, in effect, is that I put myself in the role of the judge of first instance, to review the Sealed Documents and to come to a different conclusion than he did. That is not something I am prepared to do. It is not appropriate, on this motion for a stay, to essentially make a fresh determination of the original merits of the application.

[26] It is in the interests of justice to grant the motion for a stay. The order of this court dated May 8, 2019 therefore is stayed pending the filing and determination of the moving parties' application for leave to appeal to the Supreme Court of Canada and the sealed materials shall accordingly remain sealed during this period. In accordance with their undertaking to the court, the moving parties shall serve and file their application for leave to appeal to the

Supreme Court of Canada on or before June 21, 2019, and shall request that the motion, and, should leave be granted, any appeal to that court, be expedited.

[27] No costs are sought or awarded.

"K. van Rensburg J.A."